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IN THE
Supreme Court of the United States

E. JOSEPH FACE, JR., COMMISSIONER OF FINANCIAL INSTITUTIONS, BUREAU OF FINANCIAL INSTITUTIONS, VIRGINIA STATE CORPORATION COMMISSION, ET AL.,
Petitioners,

v.

NATIONAL HOME EQUITY MORTGAGE ASSOCIATION,
Respondent.

On Petition For Writ of Certiorari
To The United States Court of Appeals
For The Fourth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Whether Congress, by enactment of the "Alternative Mortgage Transaction Parity Act of 1982," ("AMTPA"), Title VIII of Pub. L. 97-320, preempted state-law limitations on prepayment penalties chargeable by "housing creditors" in connection with "alternative mortgage transactions."

Whether Congress, by enactment of AMTPA, authorized the Federal Home Loan Bank Board to promulgate regulations that would preempt such state-law limitations.

Whether, after expiration of the "opt-out" period Congress extended to the states during which a state might avoid the AMTPA preemption, the Office of Thrift Supervision (successor to the Federal Home Loan Bank Board) may, pursuant to AMTPA, preempt one or more additional state laws in the process of revising the agency's regulations governing the operation of federal savings institutions.

PARTIES TO THE PROCEEDING

Petitioners

E. Joseph Face, Jr., Commissioner of Financial Institutions, Bureau of Financial Institutions, Virginia State Corporation Commission, and Susan E. Hancock, Deputy Commissioner, Bureau of Financial Institutions, Virginia State Corporation Commission.

Respondent

National Home Equity Mortgage Association.

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CONSTITUTIONAL PROVISIONS

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Petitioners respectfully request that this Court issue a writ of certiorari to review the judgment entered in this case by the United States Court of Appeals for the Fourth Circuit.

OPINIONS BELOW

The opinion of the Court of Appeals (Pet. App. 23a) is reported at 239 F.3d 633. The memorandum opinion of the District Court (Pet. App. 1a) is reported at 64 F. Supp. 2d 584.

JURISDICTION

The judgment of the United States Court of Appeals for the Fourth Circuit was entered on February 7, 2001. On April 27, 2001, the time for filing a petition for a writ of certiorari was extended to June 7, 2001, by the Chief Justice. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS

Article VI of the United States Constitution provides in pertinent part: "This Constitution, and the laws of the United States which shall be made in pursuance thereof . . . shall be the supreme law of the land; . . ."

The Tenth Amendment to the United States Constitution provides: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people."

The "Alternative Mortgage Transaction Parity Act", Title VIII of the Garn-St. German Depository Institutions Act of 1982, is reprinted at Pet. App. 37a.

Sections 6.1-330.83 and 6.1-330.85 of the Code of Virginia provide:

> § 6.1-330.83. Prepayment penalty for loan secured by home occupied by borrower. — The prepayment penalty in the case of a loan secured by a mortgage or deed of trust on a home which is occupied or to be occupied in whole or in part by a borrower shall not be in excess of two percent of the amount of such prepayment.
>
> § 6.1-330.85. Prepayment by borrower of loan described in § 6.1-330.71; rebates for unearned interest. — A. Any borrower under any loan described in § 6.1-330.71 shall have the right to anticipate payment of his debt in whole or in part at any time. As agreed to by the borrower, a lender may contract for a penalty for prepayment of the full amount of the loan, but such prepayment penalty shall not exceed two percent of the principal amount prepaid. However, such prepayment penalty may not be imposed if (i) the loan is refinanced or consolidated with the same lender or a subsequent noteholder or (ii) the loan is accelerated due to default. No penalty shall be charged in the event of partial prepayment or in the case of an open-end credit plan where there is a payment of the outstanding balance without a demand to release the subordinate deed of trust or mortgage. In cases where interest has been added to the face amount of a note payable in installments, the borrower shall have the right to a rebate of any unearned interest, which

rebate shall be computed in accordance with the Rule of 78 as illustrated in § 6.1-330.86 on loans (i) with an initial maturity and corresponding amortization period of sixty-one months or less and (ii) payable in equal periodic installments. On loans with an initial maturity of more than sixty-one months, the borrower shall receive a rebate computed under a method at least as favorable to the borrower as the actuarial method.

B. The provisions of this section shall not apply to any loan made by any lender enumerated in § 6.1-330.73.

STATEMENT

I. Background.

Congress enacted the Alternative Mortgage Transaction Parity Act ("AMTPA" or "the Act"), Title VIII of the Garn-St. Germain Depository Institutions Act of 1982 October 15, 1982. The AMTPA enabled housing creditors, as defined in the Act, to make alternative mortgage transactions ("AMTs") in accordance with certain Federal Home Loan Bank Board ("FHLBB") regulations, notwithstanding state law.

Section 807(b) of the Act directed the FHLBB (and two other agencies) to identify specific portions of its federal savings institutions regulations as being appropriate for use by state housing creditors in making AMTs. The FHLBB carried out § 807(b)'s directive in three separate rulemakings; in these rulemakings the FHLBB designated its regulations enabling adjustments to mortgage-loan rates, payments, and the length of a loan, and permitting the deferral and capitalization of interest. Such loan terms were contrary, in

1982, to the mortgage lending laws of a number of states. The FHLBB classified its other regulations, including its prepayment regulation, which was separate from its AMT regulations and was applicable to loans secured by a lien on a home generally, as inappropriate and inapplicable for state housing creditors' use.

This state of affairs continued throughout the three-year "opt-out" period provided states under AMTPA -- indeed it lasted for some thirteen years after passage of the Act. Although the FHLBB revised its regulations a number of times during these years, no substantive change affecting prepayments on alternative mortgage transactions occurred until 1996.

In January of 1996 the Office of Thrift Supervision ("OTS"), which had replaced and succeeded to the duties of the FHLBB in 1989, undertook a comprehensive revision of its regulations governing federal savings institutions' lending and investing. On April 30, 1996, the OTS' chief counsel opined in a letter that Wisconsin's prepayment law was preempted by AMTPA. When the final revised OTS regulations were published in September of 1996, they provided, purportedly pursuant to § 807(b) of AMTPA, that housing creditors could make alternative mortgage transactions using the OTS prepayment regulation to the exclusion of state law.

Section 805 of the AMTPA had offered states a three-year "opt-out" period, during which time any state could provide by law or referendum that the preemption effected by the AMTPA would not apply to AMTs subject to that state's laws. Some five or six states did opt-out; Virginia did not.

Virginia statutes have limited prepayment penalties on all residential mortgage loans at least since the 1960's.

Virginia's mortgage lending, banking, and savings-and-loan statutes were modified in the early 1980's in order to enable alternative mortgages. Virginia enacted a "Mortgage Lender and Broker Act" (Chapter 16, Title 6.1 of the Code of Virginia) in 1987, providing for the licensing and supervision of persons making or brokering loans secured by Virginia residences.

For more than 13 years between 1982 and 1996, no lender or institution questioned the efficacy of the Virginia prepayment penalty laws, and thousands of alternative mortgages have been made over the years on the security of Virginia homes. Many such loans have been made by "housing creditors" licensed under the Mortgage Lender and Broker Act.

II. Procedural History.

In June, 1999, the National Home Equity Mortgage Association ("NHEMA" or "Respondent") filed suit in the District Court against E. Joseph Face, Jr., Commissioner of Financial Institutions and Susan E. Hancock, Deputy Commissioner. NHEMA is a trade association whose members consist of home mortgage lenders and others. Face and Hancock are employees in the Bureau of Financial Institutions ("Bureau") of the Virginia State Corporation Commission, a permanent commission established by the Constitution of Virginia, charged with a multitude of regulatory responsibilities, including the examination of home mortgage lenders. (Constitution of Virginia, Article IX, §§ 1 and 2.) The Bureau is the division of the Commission through which it administers the financial institutions laws of Virginia.

The jurisdiction of the District Court was premised upon 28 U.S.C. §§ 1331 and 1337. NHEMA claimed that its mortgage lender members had a "federal right", when

making certain home mortgage loans, to charge prepayment penalties in whatever amount they could induce Virginia borrowers to agree to, notwithstanding the limits on prepayment penalties contained in §§ 6.1-330.83 and 6.1-330.85 of the Code of Virginia (p. 2-3, supra). Respondent based this asserted federal right upon the provisions of AMTPA, certain regulations promulgated by the federal Office of Thrift Supervision ("OTS"), and interpretations of AMTPA and OTS regulations by OTS counsel.

Petitioners Face and Hancock were named as defendants because of their role in Virginia as state regulators of NHEMA mortgage lender members licensed under Virginia's Mortgage Lender and Broker Act, § 6.1-408 et seq. of the Code of Virginia. Respondent alleged imminent danger of loss of the claimed federal right because of an article in an April, 1999 publication of the Bureau of Financial Institutions called "The Compliance Connection". This article expressed the position that the cited Virginia statutes limiting prepayment penalties were not preempted by AMTPA or OTS regulations (Pet. App. at 68a). NHEMA sought temporary and permanent injunctions against Petitioners Face and Hancock prohibiting them from "enforcing" the position taken in the article, and an award of attorney fees incurred in the case under 42 U.S.C. § 1988.

The District Court allowed Mark L. Earley, Attorney General of Virginia, to intervene in the case. On cross motions for summary judgment the District Court ruled in Respondent's favor, holding that AMTPA and/or current OTS regulations preempt the cited Virginia statutes limiting prepayment penalties in connection with "alternative mortgage transactions" made by NHEMA members, and permanently enjoining Petitioners from enforcing the

preempted statute in that context. On February 7, 2001, the Court of Appeals affirmed the lower court's judgment.[1]

REASONS FOR GRANTING THE WRIT

This case presents an important substantive question of federal law -- whether the states have been ousted by federal statute or agency rules from enacting or enforcing laws applicable to state-regulated housing creditors, which laws restrict mortgage loan terms for the protection of a state's citizens. The lower court's decision effects such an ouster. The question of the states' ability to enact and enforce borrower protection measures is of great significance in our society, in which second (and third) mortgages and home equity lines of credit have become widely used financing tools for the American family, and when aggressive, "predatory" lenders have come under scrutiny

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[1] The trial court withheld action on NHEMA's motion for an award of attorneys fees pending the decision of the Court of Appeals. On April 5, 2001, after the filing of briefs and oral argument on this aspect of the case, the District Court awarded Respondent $79,750 for attorneys fees and costs incurred in the trial and appellate courts to that date. An appeal of this ruling has been taken to the Court of Appeals, in which issues of the propriety of invocation of 42 U.S.C. § 1983 and immunity of state officials from monetary awards under the Eleventh Amendment to the Constitution of the United States are raised. Petitioners believe that these issues would be made moot by a favorable decision of this Court on the merits of this Petition.

Petitioners Face and Hancock are not "judicial officers", and therefore may be liable for such fees in a proper case. The three Commissioners of the State Corporation Commission are. The role of Face and Hancock in "enforcing" the challenged Virginia laws is somewhat indeterminate. This entire action raises the disturbing prospect of state officials being held liable for substantial attorneys fees on the basis of the otherwise unremarkable action of expressing an opinion as to the validity of theretofore unchallenged state statutes.

from Congress, state legislatures, and local government officials.[2]

The specific state laws at issue in this case restrict prepayment penalties. Although any loan contract can contain a prepayment penalty provision, such terms are ordinarily associated with longer-term loans. Lenders seek to use these penalties to discourage the early payment of loans; early payment obliges the lender to "redeploy" capital and can disrupt the lender's (or, "investor's") income flow. Borrowers, on the other hand, think it odd that prompt debt repayment should be penalized -- if and when they discover their liability for such a charge. Prepayment penalties historically have been a form of disfavored "exit fee", exacted as the price of early termination of the debtor/creditor relationship. Many states' laws prohibit the imposition of prepayment penalties in various classes of consumer credit transactions. In the particular context of home mortgage loans, some states prohibit lenders from charging prepayment penalties, and some states impose no limits. The General Assembly of Virginia has determined that borrowers who give a lien on their home as security for a loan ought not to be penalized more than 2% for early payment of such debt.

Virginia and other states, whose representatives have advised Petitioners of their desire to participate in this case as amici, regard their laws restricting prepayment penalties as important protections for their citizens against oppressive and predatory lending practices. The rationale and result of the decisions of the courts below in this case present a

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[2] The OTS published, in April, 2000, an Advance Notice of Proposed Rulemaking ("ANPR"), which acknowledged that "high" prepayment penalties "that prevent borrowers from refinancing or selling their home" are often associated with "predatory" loans. See 65 FR 17811, dated April 5, 2000, at p. 17814.

significant threat to the states' ability to protect their homeowner or would-be homeowner citizens against the exaction of large penalties for the privilege of shopping the market for a lower cost mortgage loan, or of extricating themselves from a high-cost home mortgage loan agreement they may have entered into improvidently, or out of urgent necessity.

The court of appeals' reasoning could also be used to overturn state laws that provide a host of other borrower protections (e.g., limits on late charges). Recently, a lender sought unsuccessfully to extend the AMTPA-OTS preemption to override North Carolina's statutory limit on attorneys' fees in connection with notes, conditional sales contracts and other evidences of debt. See In re Callie Smith Jones, 2000 Bankr. LEXIS 1741. (Bankr. E.D. N.C.)

This case presents, moreover, significant issues about how state law may be preempted. Petitioners assert that state-law preemption must occur at a specific, identifiable point in time. A state has the right to be informed of its being preempted. Where the preemption is by a federal agency's regulation, there must be some definite Congressional statement of the agency's authority to preempt. When a party asserts that state law has been preempted, the burden of showing the preemption's occurrence and the authority of a preempting agency should not be on the state. The state's laws are presumed effective until preemption is shown.

If allowed to stand, this lower court's decision would permit a federal agency, lacking clearly-defined preemption authority, to wait until the period expires within which a state is able to opt out of a federal regime, and then, perhaps years later, override additional state statutes.

The decision of the appeals court sanctions an abrogation of Virginia's constitutional prerogatives, under the Tenth Amendment to the Constitution of the United States, without Virginia's knowing consent.

At the time of enactment of AMTPA, Virginia law contained no prohibition against any type of lender engaging in "alternative mortgage transactions", as defined in that Act. Mortgage loan transactions involving variable interest rates and negative amortization were specifically allowed under then § 6.1-330.37 of the Code of Virginia (Pet. App. at 65a), and no Virginia law barred any of the other repayment term variations specified in 12 U.S.C. § 3802(1). There was no reason to suppose Congress thought laws restricting prepayment penalties constituted an impediment to engaging in alternative mortgage transactions. Clearly, if that had been the Congressional view, it would have repealed the prohibition against federal credit unions charging prepayment penalties, found at 12 U.S.C. § 1757(5)(A)(viii), (Pet. App. at 64a) or at least made that prohibition inapplicable to alternative mortgage transactions made by federal and state-chartered credit unions. It did not take that step.

Laws governing lending practices traditionally have been a state police law prerogative. Petitioners submit that the preservation of state legislative power under the Tenth Amendment is of equal, if not greater, importance as the preservation of state immunity from suit under the Eleventh Amendment. In the latter and related contexts, the Court has held that when Congress affords the states a choice relating to the relinquishment of a constitutionally-protected state prerogative, the choice must be a clear one, Pennhurst State School v. Halderman, 451 U.S. 1 (1981); Pennhurst II, 454 U.S. 89 (1984); Atascadero State Hospital v. Scanlon, 473 U.S. 234 (1985). Under AMTPA, 12 U.S.C. § 3804, the states were given a three-year period during which they

could "opt-out" of preemption of their laws effected by the Act. As Petitioners demonstrate below, nothing in the language of AMTPA or attendant legal considerations suggested that state prepayment penalty laws were imperiled. Thus, the 1996 OTS actions and the judgment of the appeals court in this case effectively deprive Virginia of its Tenth Amendment legislative authority without fair notice.

The decision of the appeals court failed to reconcile properly the preemptive reach of AMTPA with the preservation of state prepayment penalty laws under Pub. L. No. 96-221, the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA").

The position expressed in the Bureau's "The Compliance Connection", about which the Respondent complains, was based not only upon the language of AMTPA, but also upon the effect of DIDA, a shortly-prior (1980) Congressional enactment upon the same subject matter as AMTPA -- home mortgage lending. (Pet. App. at 68a.) Both laws were reactions to the volatile and increasingly high market interest rates that prevailed in the 1970s and early 1980s, and the resulting inability of depository institutions to make home mortgage loans available to home buyers at low fixed interest rates.[3] Under Title V of DIDA, state interest rate limits on "federally related mortgage loans", as defined in 12 U.S.C. § 1735f-5(b) (Pet. App. at 61a), were preempted, 12 U.S.C. § 1735f-7a (Pet. App. at 63a). A side-by-side comparison of these two enactments reveals that they apply to the same types of loan made by the same types of lenders. Alternative mortgage transactions are, viewed analytically, a subset or subcategory of federally related mortgage loans. Thus, the

[3] See Eskridge, "One Hundred Years of Ineptitude: The Need for Mortgage Rules, etc.", 70 Va.L. Rev. 1083, pp. 1102-1110.

two enactments are in pari materia and should be construed in a manner which harmonizes them, Vimar Seguros v. M/V Sky Reefer, 515 U.S. 528 (1995), 82 C.J.S. Statutes § 366.

Under DIDA, at 12 U.S.C. § 1735f-7a, state laws "limiting the rate or amount of interest, discount points, finance charges, or other charges [emphasis added]" that could be imposed on home mortgage loans were preempted subject to possible state opt-out. Giving the "other charges" language a broad reading, one might deduce a Congressional intention to override state prepayment penalty law limitations. However, Congress said that "other charges" shall not be construed to mean prepayment charges, attorneys' fees, late charges, or other borrower protection provisions applicable to home mortgage loans.[4] This Congressional declaration is echoed verbatim by the OTS at 12 C.F.R. § 590.3(c), promulgated under DIDA (Pet. App. at 67a).

Neither the decision of the appeals court, nor the current OTS AMTPA regulation it endorses, can be reconciled with this straightforward declaration of Congressional intent. The construction adopted by the courts below, therefore, clearly contravenes the rule of statutory construction applicable to laws in pari materia. In addition, inasmuch as a given home mortgage loan that qualifies as an "alternative mortgage transaction" under AMTPA will usually also constitute a "federally related mortgage loan" under DIDA, the decision below results in conflicting state and federal rules relating to prepayment penalties applying to the same loan. Such a result is contrary to the rule that statutes of doubtful import should not be construed so as to produce absurd consequences, In re Pacific-Atlantic Trading Co., 64 F.3d 1292 (CA 9, 1995), 82 C.J.S. Statutes, § 326.

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[4] S. Rep. No. 368, 96 Cong. 2d Sess. 19 reprinted in 1980 U.S.C.C.A.N. 236, 255.

The appeals court concluded, erroneously, that Virginia law was preempted, because the court (1) failed to construe AMTPA as a whole, (2) failed to consider post-enactment FHLBB actions under AMTPA, and (3) misconstrued the "history" surrounding AMTPA's enactment.

The preempting language of 12 U.S.C. § 3803(c) is so broad that it cannot be accepted without qualification. But one need not look far to find the limits intended by Congress. There is a reference in 12 U.S.C. § 801(a)(3) to the several federal regulators' then-existing regulations "authorizing . . . alternative mortgage financing". Further, 12 U.S.C. § 803(b) announces Congress' purpose in AMTPA as being to achieve parity for non-federally chartered housing creditors "by authorizing [them] . . . to make, purchase, and enforce alternative mortgage transactions so long as the transactions are in conformity with the regulations issued by the Federal agencies." (Emphasis supplied.)

Next, § 807(b) of the Act directs the several agencies to "identify, describe and publish" (and conform, as necessary) their AMT-enabling regulations. Because § 807(b) was placed as a note to § 801 when AMTPA was codified, it has not been given the respect it deserves by the lower courts. We submit that § 807, in pari materia with the other sections of the AMTPA, is vital to the Act; it establishes the means of setting the bounds on AMTPA's preemption of states' laws.

The strongest indications of the scope of AMTPA's intended preemption are found in the FHLBB's responses to the Act shortly after its passage. On November 17, 1982, the FHLBB published (47 F.R. 51733) the first of three "Notice(s) to Housing Creditors", as an Appendix to its Operations (12 C.F.R. 545) regulations for federal thrifts.

(Pet. App. at 45a.) An additional "Notice" appeared May 23, 1983 (48 F.R. 23076), (Pet. App. at 56a), and on October 26, 1984 (49 F.R. 43043) the FHLBB made a technical adjustment. In none of these three publishings, did the FHLBB designate as appropriate and applicable for use by housing creditors in exercising their AMTPA lending ability its regulation relating to prepayments, viz. 12 C.F.R. § 545.8-5(b). (Pet. App. at 53a, 54a.) Rather, the FHLBB categorized that regulation as "inappropriate and inapplicable".

As the January 1, 1983 regulations of the FHLBB (Pet. App. 48a-55a) show, the regulations identified in the FHLBB's November 17, 1982 "Notice", viz., 12 C.F.R. 545.6-2(a)(2), (7) appear under the heading "Other Residential Real Estate Loans". This is primarily an enabling rule under the larger category "Real Estate Loans". (Pet. App. at 48a.) By way of contrast, the prepayment regulation, 12 C.F.R. § 545.8-5(b) appears under "Loan Payments", a subcategory of "General Provisions Respecting Loans", it applies to all home mortgage loans, and is restrictive in character. (Pet. App. 53a, 54a.)

Perhaps the best statement of the FHLBB's thinking as it carried out its § 807(b) task appears in the May 23, 1983 FHLBB rulemaking:

> This [§ 803 of AMTPA] definition, however, requires that permissible transactions be described and defined by applicable regulation.
>
> Section 807(b) directs the Board to identify, describe and publish those portions of its regulations that are inappropriate for, and thus inapplicable to, the non-federally chartered housing creditors. On

November 17, 1982, the Board published a "Notice to Housing Creditors" (47 FR 51732, 51733), and requested comments thereon. The Notice provided that housing creditors that are not commercial banks, credit unions or federal associations may make alternative mortgage loans secured by a single-family dwelling or dwelling units for four or fewer families, subject to the limitations contained in 12 CFR 545.6-2(a)(2), (7) (as amended, 47 FR 36612 (1982)). These housing creditors would, therefore, comply with the Board requirements on adjustments to rate, payment, balance or term and on disclosure. Requirements concerning loan-to-value ratios and other requirements designed to ensure safety and soundness in residential real estate lending by Federal associations were deemed inappropriate for, and thus inapplicable to, these housing creditors. For all other residential real property loans, all requirements as to adjustments to rate, payment, balance or term, and to disclosures were deemed inappropriate and inapplicable as well.

The Board's approach to the applicability of its regulations is premised on the clear statement of Congressional intent that Title VIII "does not place non-federally chartered housing creditors under the supervision of the federal agencies, but instead merely enables them to follow a federal program as an alternative to state law." S. Rep. No. 97-463, 97th Cong., 2d Sess. 55. The Notice to Housing Creditors should, therefore, identify as appropriate those

regulations that further "describe and define" (section 803(1)) alternative mortgage transactions, and not those regulations intended for the general supervision of Federal associations. Also, those requirements applicable to mortgage lending generally (*i.e.*, fixed-rate, fixed-term, fully amortized loans as well as alternative mortgage transactions) are deemed inappropriate because they do not further "describe or define" alternative mortgage transactions defined in section 803(1) of Pub. L. 97-320.

The comments received on the November 17, 1982 Notice raised a number of issues. Some commenters requested that the Notice be expanded to include references to partially amortized loans, to forty year amortization limitations, to regulations on manufactured home loans, and to loan-to-value requirements.

In responding to these suggestions, the Board adheres to the approach that those regulatory provisions that describe and define alternative mortgage transactions should be deemed applicable, but those provisions that apply generally to mortgage loans, those outside of the authority granted by Title VIII, and those imposed on Federal associations for safety and soundness purposes should not be applied. The revised Notice, therefore, does not include a reference to the forty year amortization limit because this requirement is not one particular to alternative mortgage transactions. The provisions on loan-to-value ratios are not deemed appropriate because

they reflect the consideration of safety and soundness in the Board's supervision of Federal associations. References to manufactured home loans or other types of loans are not included in the Notice because section 803(1) clearly defines the types of loans to which the authority to make alternative mortgage transactions is applicable.

The final rule incorporates a revised Notice to Housing Creditors as an Appendix to Part 545. The Board believes that codification of the Notice in this manner will make reference to the applicable regulations easier for housing creditors that must rely on the regulations pursuant to section 804(a)(3). The revised Notice references the basic authority to make alternative mortgage transactions and the statutory definition set forth in section 803. The Notice identifies only the following rules as applicable:

§ 545.33(c), setting forth the authority to make partially amortized or non-amortized loans and to adjust the interest rate, payment, balance, or term to maturity;

§ 545.33(e), setting forth limitations on adjustments to loans secured by borrower-occupied property; and

§ 545.33(f)(4) thru (11), setting forth requirements for disclosures on loans secured by borrower-occupied property that are not fixed-rate and fully amortized.

> The Board believes that these provisions are an integral part of, and particular to, alternative mortgage transactions made by Federal associations. The adjustment and disclosure provisions are further limited in applicability to loans secured by borrower-occupied property, and therefore are limited in the same manner for housing creditors other than commercial banks and credit unions. All other regulations are deemed inappropriate and, therefore, inapplicable. (Pet. App. 57a-59a.)

These shortly after-AMTPA writings of the FHLBB make it clear that the agency then understood -- and correctly carried out -- its limited role in the preemption effected by the Act. Remarkably, these clear statements by the agency charged with a duty under AMTPA have been ignored by the OTS, its counsel, and the lower courts.

Petitioners submit that the above analysis and history -- not the "persuasive indicator" from history put forth in the court of appeals' decision -- represent the correct legal view of the scope of AMTPA. The Fourth Circuit erred in attaching significance to certain explanatory material in an August, 1982, FHLBB rulemaking (47 F.R. 36612, 36615) which the court said "clearly place[d] the regulation of pre-payment penalties within the regulation of "alternative mortgage instruments." (Pet. App. at 31a, 32a.) In fact that August, 1982 rulemaking, which established the FHLBB regulations in effect at the date AMTPA was passed, separated the FHLBB's regulation on prepayment from its AMT regulations. This prepayment regulation, by its terms, applied generally to "all loans on real estate" or to "a loan secured by a home or a combination of home and business property". (See 12 C.F.R. § 545.8-5, "Loan Payments," Pet. App. 53a, 54a.) It is the regulations in effect at the time of

enactment -- not former ones that have been replaced -- that determine the Act's scope, Petitioner urges.

Congress gave the FHLBB -- and its successor, the OTS -- no authority to expand the scope of AMTPA's state-law preemption on behalf of housing creditors.

The FHLBB/OTS's authority to make preemptive rules for federal savings associations is (1) set forth clearly in 12 U.S.C. § 1464, and (2) premised on the national need to protect the safety and soundness of the system of institutions for the support of housing. This preemptive authority is not without limits, as this Court's 1982 decision in Fidelity Federal Savings and Loan Assn. v. de la Cuesta (458 U.S. 141) and the response to that decision represented by Title III of the Garn-St. Germain Act make clear. (See S. Rep. No. 97-536, pp. 20-25, 1982 U.S.S.C.A.N. 3074.)

The Court's decision in de la Cuesta, supra, and Title III of the Garn-St. Germain Act provide strong support for construing AMTPA more narrowly than the courts below have done. It "flies in the face of reason" to accept the notion (as Respondent's position would necessitate) that -- after a court battle over the scope of the FHLBB's authority to preempt state lending law for the benefit of federal savings institutions, and after having painstakingly confirmed in Title III the Court's due-on-sale clause holding -- Congress would have turned right around and given the FHLBB rulemaking authority over housing creditors, particularly in view of AMTPA's cryptic "legislative history". (See S. Conf. Rep. No. 97-641, 1982 U.S.C.C.A.N. 3054, and S. Rep. No. 97-536.)

The AMTPA itself contains no grant of authority to the FHLBB/OTS to make rules affecting state-regulated housing creditors. True, the language of 12 U.S.C. § 3803(a) requires adherence to the FHLBB's AMT regulations "to the

extent that such regulations are authorized by rulemaking authority granted to the Federal Home Loan Bank Board with regard to federally chartered savings and loan associations under laws other than this section." This allusion to the FHLBB's plenary rulemaking authority over federal thrifts could be misconstrued as somehow granting equivalent authority to make rules affecting housing creditors. But actually that language is in the Act for the purpose of limitation, and the reason for its inclusion relates to history. At the time of the Act, this Court had just decided the de la Cuesta case, and the Comptroller of the Currency was involved in litigation over its authority to issue an adjustable rate mortgage regulation that preempted state law. (See S. Rep. No. 97-463, p. 15). In that context the quoted language is rightly understood as designed to exclude any then-existing federal AMT regulations that might later be found by a reviewing court to have been beyond the enacting agency's authority.

True also, the sparse, ambiguous legislative history of AMTPA states that subsequent changes in the federal agencies' regulations "that are within the scope of this Title" will apply to (or be available to) housing creditors. (See S. Rep. No. 97-463, at 55.) This is no grant of rulemaking power. This simply means that the § 807(b)-specified regulations are not thereafter frozen. Amendments to regulations so specified, and thus within the scope, will apply to housing creditors as well as federal associations. Within the scope of the Act, parity is to be maintained. That does not mean, however, that a federal agency is free to expand the scope by including additional regulations, thus preempting more state laws. Petitioners submit that is just what the OTS did in its 1996 rulemaking, and further, that the OTS did so without legal authority.

In this case, thus far, a federal agency has been allowed, without Congressional authority, to usurp Virginia's

Tenth Amendment right to govern the terms of residential mortgage loan contracts on behalf of its citizens vis-à-vis state-chartered and licensed housing creditors. This has occurred, with all due respect to the lower courts, without any satisfactory explanation of when and how the alleged preemption occurred.

Since the AMTPA makes no mention of prepayment penalty laws, and since the FHLBB -- acting correctly in 1982-84, we submit, pursuant to § 807(b) -- did not identify its prepayment regulation as one of those to be used by state housing creditors in lieu of state laws, it must be that the alleged preemption took place in 1996.

Well, then, was Virginia law overridden by OTS counsel's April, 1996 letter on the Wisconsin prepayment penalty law? (Pet. App. 71a.) That letter is defective in several respects, but principally it fails to consider the 1982-84 actions of the FHLBB as a reliable indication of Congress' intended scope for AMTPA. Even if counsel's reasoning were sound, however, federal agencies' counsel do not have the power to set aside state law.

Virginia's law, then, must have been preempted by the OTS's revised (1996) regulation, 12 C.F.R. § 560.220. The regulation adopted September 30, 1996, purports to rely on § 807(b). But how can a provision of law consisting of a directive to be carried out by an agency in the 60 days after October 15, 1982, be the basis for substantively expanding state-law preemption in 1996, almost 14 years after the Act? Petitioners submit that the OTS here confused its limited role under § 807(b) of the AMTPA with its broad authority to make rules for federal savings institutions.

The 1996 actions of the OTS -- its counsel's opinion and its revised regulation, 12 C.F.R. 560.220 -- should be given no deference by this Court. Rather than being

permitted to underpin judicial holdings, as the lower courts have permitted these actions to do, scrutiny by the Court should result in their being declared invalid. The opinion and the regulation confuse the FHLBB/OTS's role as rulemaker for federal savings associations with the finite assignment given the FHLBB under § 807(b) of AMTPA, with respect to state-regulated mortgage lenders.

The parity sought by Congress in AMTPA was limited; it was simply this: that housing creditors should be able to make AMT's. There is no basis in AMTPA for the conclusion that Congress intended state housing creditors to be on a par with federal savings associations in terms of their ability to contract for, enforce, and receive prepayment penalties.

When Congress intends to give a federal agency rulemaking authority, it knows how to do so. In 12 U.S.C. §§ 1463(a) and 1464(a), Congress speaks thus: "The Director [of OTS] may issue such regulations as the Director determines to be appropriate . . ." and thus: ". . . the Director is authorized, under such regulations as the Director may prescribe, (1) to provide for . . .." Contrast that expansive language with AMTPA, § 807(b): "Within sixty days of the enactment of this title, the Comptroller of the Currency, the National Credit Union and the Federal Home Loan Bank Board shall identify, describe and publish those portions or provisions of their respective regulations . . .." The AMTPA simply lacks any grant of authority to make rules.

In its eagerness in 1996 to free not only its federal savings institutions, but also state housing creditors, from market-disparaged lending constraints, the OTS simply paid no attention to (1) § 807(b)'s directive to the FHLBB was for a 60-day period in 1982, and (2) that the OTS was not free to incorporate by reference federal savings association rules

based on 12 U.S.C. § 1464. That is what it did in its September 30, 1996 final rule.

Because the lower courts have avoided pinpointing when and how the alleged preemption occurred, Petitioners must address the OTS' 1996 actions. The OTS counsel's April letter and its 1996 rulemaking -- on which the lower courts' findings of preemption are founded -- are substantively incorrect. They do not conform to Congress' intent in the AMTPA. The OTS counsel's letter ignores historic, FHLBB indicators of the scope of the AMTPA preemption, jumps too quickly to embrace AMTPA's vague statement of purpose, and reads "parity" too broadly. Then the letter says, in effect, "oh well, we are fixing it in an ongoing rulemaking anyway", while disingenuously characterizing the change as not substantive, but merely clarifying. (Pet. App. at 74a, 75a, especially footnote #12.)

Moreover, the preemption found to have occurred by these actions is procedurally and Constitutionally defective in that the preemption is accomplished without authority and occurs without the states' knowledge, much less their consent. The opt-out opportunity Congress provided the states has been made meaningless; the states have been "sandbagged". These transgressions require judicial scrutiny; they should not be permitted to stand.

This is a case of first impression at the appellate court level. It is essential that the proper scope of AMTPA be established, based on a thorough review and understanding of Congress' intent in the Act, correct analysis, and the application of proper principles of preemption. Only then will the proper allocation of authority as between states and the federal agency be restored.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Richmond Division

NATIONAL HOME EQUITY MORTGAGE ASSOCIATION, Plaintiff, v. E. JOSEPH FACE, JR., Commissioner of Financial Institutions, Bureau of Financial Institutions, Virginia State Corporation Commission, SUSAN E. HANCOCK, Deputy Commissioner, Consumer Finance, Bureau of Financial Institutions, Virginia State Corporation Commission Defendants, MARK L. EARLEY, Attorney General of Virginia Intervenor-Defendant.	Civil Action Number 3:99cv398

MEMORANDUM OPINION

This matter is before the Court on the parties' cross motions for summary judgment regarding the Alternative Mortgage Transaction Parity Act of 1982, 12 U.S.C.

§§ 3801-06, ("the Parity Act") and whether it preempts Virginia laws limiting prepayment penalties. National Home Equity Mortgage Association ("NHEMA" or "plaintiff") has filed a motion for summary judgment asserting that the Parity Act preempts Virginia laws. Defendants E. Joseph Face, Jr., Commissioner of Financial Institutions, Bureau of Financial Institutions, Virginia State Corporation Commission, and Susan E. Hancock, Deputy Commissioner, Consumer Finance, Bureau of Financial Institutions, Virginia State Corporation Commission ("SCC defendants") and Intervenor-Defendant Mark L. Earley, Attorney General of Virginia ("the Attorney General") have also filed motions for summary judgment, both asserting that the Parity Act does not apply to Virginia's statutory prepayment penalty limits. Responses have been filed to each of these motions and, accordingly, the motions are ripe.

Summary judgment may be granted if, after consideration of such items as depositions, affidavits or certifications, and after viewing the facts in the light most favorable to the non-moving party, "there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c); Celotex Corp. v. Catrett, 477 U.S. 317, 322-23, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). The parties concede, and the Court agrees, that no material facts are in dispute and that summary judgment is appropriate. For the reasons stated below, the Court grants plaintiff's motion for summary judgment, denies SCC defendants' motion for summary judgment, and denies the Attorney General's motion for summary judgment. The Court permanently enjoins defendants from enforcing their announced position that the Parity Act does not preempt Virginia state law limiting prepayment penalties on alternative mortgage transactions.

I. FACTUAL BACKGROUND

The plaintiff, NHEMA, is the largest national trade association focusing primarily on the home equity lending market. Members of this voluntary trade association include banks, mortgage lending corporations, secured equity lenders, law firms, title insurers, consulting firms, and appraisal services corporations. NHEMA membership includes entities that are currently licensed by the Bureau of Financial Institutions, Virginia State Corporation Commission, to conduct business in the Commonwealth of Virginia, and that also qualify as housing creditors under the Parity Act, 12 U.S.C. §§ 3801-06, and are thus subject to its provisions.

The Parity Act was passed by Congress in 1982 in order "to eliminate the discriminatory impact . . . [that federal] regulations have upon nonfederally chartered housing creditors and provide them with parity with federally chartered institutions. . . ." 12 U.S.C. § 3801(b). The Parity Act afforded housing creditors[1] the general authority to make, purchase, and enforce alternative mortgage transactions ("AMTs"). 12 U.S.C. § 3803. An AMT describes a residential-based loan or credit sale in which the lender may raise the interest rate, renegotiate the finance charge, or implicitly adjust the mortgage rate by allowing debt to mature faster than anticipated in the original amortization schedule.[2]

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[1] The Parity Act defines a "housing creditor" in relevant part as "any person who regularly makes loans, credit sales, or advances secured by interests in properties . . . or any transferee of them." 12 U.S.C. §§ 3802(2)(C)-(D).

[2] An alternative mortgage transaction "means a loan or credit sale secured by an interest in residential real property, a dwelling, all stock allocated to a dwelling unit in a residential cooperative housing

The Parity Act's provision that all housing creditors have general authority to make, purchase, and enforce AMTs applies only to transactions made in accordance with regulations issued by the Director of the Office of Thrift Supervision ("OTS") governing federal savings and loan associations. 12 U.S.C. § 3803(a)(3). The Director of the OTS has rulemaking authority pursuant to 12 U.S.C. §§ 1463(a) and 1464(a) to regulate federally chartered savings and loan organizations. The Director of the OTS has given savings and loan organizations federal rights to charge prepayment penalties without regard to state laws and has ruled that state laws regulating prepayment penalties are preempted. 12 C.F.R. §§ 560.2(a), (b)(5).

The Parity Act includes a preemption provision which states that an AMT "may be made by a housing creditor in accordance with this section, *notwithstanding any State constitution, law, or regulation.*" 12 U.S.C. § 3803© (emphasis added). Congress expressly allowed each state the opportunity to opt out of the Parity Act's preemption provision between October 15, 1982 and October 15, 1985 by enacting, or adopting by referendum or constitutional amendment, a new law, stating explicitly and by its terms that the state did not want the Parity Act to preempt state

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corporation, or a residential manufactured home . . . (A) in which the interest rate or finance charge may be adjusted or renegotiated; (B) involving a fixed-rate, but which implicitly permits rate adjustments by having the debt mature at the end of an interval shorter than the term of the amortization schedule; or © involving any similar type of rate, method of determining return, term, repayment, or other variation not common to traditional fixed-rate, fixed-term transactions, including without limitation, transactions that involve the sharing of equity or appreciation; described and defined by applicable regulation." 12 U.S.C. §3802(1). The quintessential alternative mortgage transaction is an adjustable rate mortgage.

laws regarding AMTs. 12 U.S.C § 3804. During this time period, the Commonwealth of Virginia did not opt out of the Parity Act's preemption provision and did not in any way indicate that it wished Virginia state laws to govern AMTs instead of the federal Parity Act.

The Virginia General Assembly recodified statutes limiting prepayment penalties in 1987. Sections 6.1-330.83 and 6.1-330.85 of the Code of Virginia limit the amount of prepayment penalties that can be charged to two percent of the prepayment amount and forbid any penalties when the prepayment is due to refinancing with the same lender or to default. These code sections do not reference the Parity Act and were recodified after the Parity Act's opt-out time had expired.

In an official newsletter distributed to Virginia mortgage and consumer finance licensees, SCC defendants announced or permitted to be announced that the Bureau of Financial Institutions of the Virginia State Corporation Commission believes that the Parity Act does not preempt Virginia statutory laws limiting prepayment penalties for AMTs. Federal Preemption of Virginia's Prepayment Penalty Laws:, Compliance Connection, April 1999, at 1 [hereinafter Federal Preemption]. This announcement stated:

> Bureau examiners will continue to cite violations of Virginia statutes relating to prepayment penalties. Licensees found in violation will be required to refund prepayment penalties collected, in excess of the state law limits. In addition, notification . . . must be provided to current borrowers so they will be aware that any higher penalty cannot be enforced. . . . A copy of the notification must be made a part of the

> permanent loan file, and investors who have purchased loans providing for penalties in excess of the penalty set forth in the Virginia Code must be notified.
>
> In addition to possible revocation of license, such violations can be referred to the Attorney General's office for investigation pursuant to Virginia Code § 6.1-430.

Federal Preemption at 3.

II. LEGAL ANALYSIS

A. Preemption

The primary issue for determination involves preemption and specifically whether the Parity Act preempts Virginia laws regarding limits on prepayment penalties. Plaintiff argues that when Virginia failed to timely opt out of federal preemption of the Parity Act, and when state-chartered housing creditors comply with the list of federal regulations that the OTS deems appropriate for them to follow, they can avail themselves of express federal preemption under 12 U.S.C. § 3803© "notwithstanding any State constitution, law or regulation." The plaintiff relies on an opinion issued by the OTS in 1996 that concluded that the Parity Act should be interpreted as preempting a Wisconsin state statutory restriction on prepayment penalties. Effect of Parity Act on Wisconsin Prepayment Penalty Statute, OTS Op. Chief Counsel, 1996 OTS LEXIS 19 (April 13, 1996). The plaintiff also relies on a rulemaking by the OTS which clarified that prepayment penalties are covered by the Parity Act. See 61 Fed. Reg. 50,951, 50,954, adopting new regulation 12 C.F.R. § 560.220 which identifies 12 C.F.R. 560.34 as a regulation applicable to AMTs. In addition, an

opinion of the Maryland Attorney General has ruled the same as the OTS opinion. 82 Md. Op. Att'y Gen. No. 97-018 (August 19, 1997). In contrast, SCC defendants and the Virginia Attorney General argue that the Parity Act's preemption provision does not apply to Virginia's statutory prepayment penalty limits.

Simply stated, Congress gave the states a choice -- the states could choose to be regulated by the federal regime under the Parity Act, or the states could choose to opt out of the preemption provision of the Parity Act and continue the state's own regime. 12 U.S.C. § 3804. Virginia did not opt out during the requisite time period, and only now objects to the federal regime because the OTS has clarified that prepayment penalties are covered by the Parity Act. This Court holds that the Parity Act preempts the Virginia laws that attempt to limit prepayment penalties.

The OTS states in both an opinion letter and a rulemaking that prepayment penalties are included in the preemption provision of the Parity Act. IN 1996, the OTS clarified the analytical framework of the regulations affected by the Parity Act. The OTS amended 12 C.F.R. § 545.33(f) to include 12 C.F.R. § 560.34 which permits the use of prepayment penalties subject to terms of the loan contract, and recast 12 C.F.R. § 545.33(f) into the current 12 C.F.R. § 560.220 to restate the law already in existence since the Parity Act's adoption in 1982. Now, in those states that did not opt out under the Parity Act's opt-out provisions (including Virginia), housing creditors who comply with the OTS regulations listed in 12 C.F.R. § 560.220 (including the regulation permitting prepayment penalties) can rely on federal preemption under the Parity Act.

This 1996 rulemaking was predicted, supported, and its rationale explained by a 1996 OTS Opinion Letter. Effect

of Parity Act on Wisconsin Prepayment Penalty Statute, OTS Op. Chief Counsel, 1996 OTS LEXIS 19 (April 30, 1996). In that letter, the OTS explained that federal preemption was necessary in order to prevent disadvantaging state housing creditors -- Congress' express purpose in enacting the Parity Act. Id. The OTS noted that the proposed rulemaking (now enacted) was being proposed to eliminate potential confusion. "The practical effect of incorporating the OTS's permissive prepayment penalty provisions will be to confirm that no OTS restriction was intended by the omission of such provisions from § 545.33(f) [currently recast into 12 C.F.R. § 560.220]." Id. at n.12.

Although the OTS did not clarify until 1996 that prepayment penalties were included under the Parity Act's preemption provision, this does not prevent the OTS's clear statement in 1996 from being effective and enforceable. In the Parity Act, Congress provided that state chartered housing creditors may make, purchase, and enforce AMTs if they comply with "regulations . . . issued by the Director of the Office of Thrift Supervision for federally chartered savings and loan associations, to the extent that such regulations are authorized by rulemaking authority. . . ." 12 U.S.C. § 3803(a)(3). This direction implies no temporal limit on rulemaking as it applies to state chartered housing creditors. Furthermore, the creation of any limitation of the type suggested by SCC defendants[3] would defeat the stated

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[3] Defendants assert that within sixty days, the OTS was permitted to create a *one-time* list of matters that are preempted by the Parity Act. Defendants suggest that since the OTS did not do this and did not list prepayment penalties as preempted, then states may regulate this area. Defendants refer to the language in the note under 12 U.S.C. § 3801: "Within sixty days of the enactment of this title [October 15, 1982] . . . the Federal Home Loan Bank Board [predecessor to the OTS] shall identify, describe, and publish those portions or provisions of their respective regulations that are inappropriate for (and thus inapplicable

purpose of the Parity Act by having regulations applicable to state and federally chartered housing creditors diverge over time rather than remaining in parity. Finally, the legislative history reveals that these regulations were subject to amendment by the agency. S. Rep. No. 97-463, at 55 (1982). Congress noted its expectation that "any future amendments that the agencies make to regulations that are within the scope of this title will conform to the objectives of this title." Id.

The 1996 OTS opinion and regulations state that the Parity Act preempts state statutes purporting to limit prepayment penalties. In Fidelity Federal Savings and Loan Association v. de la Cuesta, 458 U.S. 141 (1982), the Court stated that "[f]ederal *regulations* have no less preemptive effect than federal statutes. Where Congress has directed an administrator to exercise his discretion, his judgments are subject to judicial review only to determine whether he has exceeded his statutory authority or acted arbitrarily." Id. at 153-54 (emphasis added). The Supreme Court described the two-prong inquiry as (1) whether the federal agency has expressed an intent to preempt state law, and if so, (2) was this within the authority of the agency. Id. Since the OTS expressed an intent to preempt state law with regard to prepayment penalties, the inquiry turns to whether the OTS had authority to issue this regulation. The Parity Act gave the Director of the OTS authority to issue regulations "to the extent that such regulations are authorized by rulemaking authority. . . ." 12 U.S.C. § 3803(a)(3). Turning to 12 U.S.C. § 1462a(b)(2), the Director of the OTS is given authority to "prescribe such regulations and issue such orders as the Director may determine to be necessary for carrying out this chapter and all other laws within the Director's

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to), or that need to be conformed for the use of, the nonfederally chartered housing creditors to which their . . . regulations apply. . . ."

jurisdiction." Thus, the OTS had a proper authority to issue this regulation, thus satisfying the second prong of the inquiry set forth in de la Cuesta.

Both the 1996 OTS opinion and the OTS regulatory construction of the Parity Act are entitled to deference under the principles set forth in Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-43 (1984). In Chevron, the Supreme Court announced a two-part test for deference to a federal agency's interpretation of a statute. Id. First, the reviewing court inquires whether the plain language of the statute addresses the precise issue. If so, that is the end of the matter because courts as well as agencies must give effect to the unambiguously expressed intent of Congress. Id. If, however, the statute is silent on the question, the agency's interpretation will be upheld if it is a permissible construction of the statute. Id. The Parity Act on its face displaces state law restricting the making, purchasing, and enforcement of AMTs when the AMTs are made in accordance with those OTS regulations that are made applicable to state chartered housing creditors. Additionally, to the extent that any such preemption is thought controversial as applied to prepayment penalties, the OTS' determination that the Parity Act does preempt these state laws is entitled to deference because it is a reasonable agency interpretation of the Parity Act. Id.

In a recent Supreme Court decision, the Court further emphasized the deference it would pay to agency interpretation of ambiguous terms in statutes. In Smiley v. Citibank (South Dakota), N.A., 517 U.S. 735 (1996), the Court held that it would defer to agency interpretation even when the opinion came 100 years after the statute -- "neither antiquity nor contemporaneity with the statute is a condition of validity." Id. at 740. The Court explained that it "accord[s] deference to agencies under Chevron . . . because

of a presumption that Congress, when it left ambiguity in a statute meant for implementation by an agency, understood that the ambiguity would be resolved, first and foremost, by the agency, and desired the agency (rather than the courts) to possess whatever degree of discretion the ambiguity allows." Id. at 740-41. Thus, in accordance with this logic, the 1996 OTS rulemaking is entitled to deference and the preemption of state laws limiting prepayment penalties is a decision Congress intended to be left to the OTS.

In conclusion, Congress gave the OTS authority in the Parity Act to issue regulations "to the extent that such regulations are authorized by rulemaking authority. . . ." 12 U.S.C. § 3803(a)(3). The OTS used that delegated authority to issue a rulemaking in 1996 that clarified that state regulation of prepayment penalties are preempted by the Parity Act. 12 C.F.R. § 560.220 (referencing 12 C.F.R. § 560.34). Thus, sections 6.1-330.83 and 6.1-330.85 of the Code of Virginia are preempted by the Parity Act.

B. Remaining Issues

1. Laches

Plaintiffs are not in laches. "[T]he affirmative defense of laches 'requires proof of (1) lack of diligence by the party against whom the defense is asserted, ad (2) prejudice to the party asserting the defense.'" New Jersey v. New York, 118 S.Ct. 1726, 1748 (1998) (citations omitted). In this case, there is no lack of diligence by plaintiffs and no prejudice to SCC defendants. Moreover, a lawsuit filed in June, shortly after the Bureau of Financial Institutions' April announcement that the Parity Act does not preempt Virginia law, is not untimely.

2. Ripeness

Plaintiff's claim is ripe for adjudication. The Supreme Court has expressly stated that federal preemption of contrary state laws presents pure questions of law ripe for adjudication through a motion for summary judgment. United Steelworkers of Am. v. Rawson, 495 U.S. 362, 365, 376 (1990) (reinstating trial court's grant of summary judgment because "federal law has preempted the field of union representation and its obligation to its membership"). Here, the underlying dispute focuses on the preemptive effect of the Parity Act on Virginia laws limiting prepayment penalties on all AMTs made, purchased, and enforced in Virginia. The dispute is thus ripe for adjudication.

3. Standing

NHEMA has standing to sue on behalf of its members. NHEMA's members are housing creditors subject to the Parity Act who are suffering or who will suffer injury from the enforcement of penalties announced in the Bureau of Financial Institutions of the Virginia State Corporation Commission's official newsletter for their lawful exercise of federal rights as violations of sections 6.1-330.83 and 6.1-330.85 of the Code of Virginia. Whenever a state appears willing to enforce an unconstitutional statute against those subject to it, then there is standing to challenge that law either by those subject to it or through their national trade organization. Hunt v. Washington State Apple Adver. Comm'n, 432 U.S. 333, 342 (1977). In addition, the law in the Fourth Circuit is clear that the threat of prosecution under an unconstitutional statute establishes such injury. Mobil Oil Corp. v. Attorney General, 940 F.2d 73, 76 (4th 1991), *cert., denied sub nom.* Virginia Gasoline Marketers and Automotive Repairs Ass'n, Inc. v. Mobil Oil Corp., 513 U.S. 1148 (1995). In this case, the threat of prosecution was

documented in the Bureau of Financial Institutions' announcement. Thus, NHEMA has standing to bring this claim.

4. Federally Enforceable Right

The plaintiff has a federally enforceable right under 42 U.S.C. § 1983. Under the three-part test in Wilder v. Virginia Hosp. Ass'n, 496 U.S. 498, 509 (1990), the plaintiff has a federally enforceable right under §1983 if: (1) its members are intended beneficiaries of the Parity Act, (2) Congress intended the Parity Act to be a binding obligation, and (3) the plaintiff's interest is not so vague that it is "'beyond the competence of the judiciary to enforce.'" Id. (citation omitted). This test is satisfied here because (1) nonfederally chartered housing creditors belonging to NHEMA are intended beneficiaries of the Parity Act, (2) the Parity Act creates a present right to be free of state law, and (3) the judicial remedies being sought are traditional and well established.

5. The Tenth Amendment

Although the Tenth Amendment is a safeguard against federal intrusion into areas traditionally regulated and supervised by the states, it does not apply here to AMTs and limits on prepayment penalties because consumer protection is not an area traditionally regulated solely by states. The United States Constitution grants to Congress the power "to regulate Commerce . . . among the several States" and also to "make all Laws which shall be deemed necessary and proper for carrying into Execution the foregoing Power[ ]. . . ." U.S. Const. Art. I, § 8, cls. 3 & 18. The Supreme Court has approved "any number of federal statutes enacted under the commerce power that [effectively] pre-empt particular exercises of state police power." Hodel v. Virginia Surface

Mining and Reclamation Ass'n., Inc., 452 U.S. 264, 292 (1981) (citations omitted). The Supreme Court expressly rejected arguments that Congress invades subject matters purportedly "reserved to the States by the Tenth Amendment simply because it exercises its authority under the Commerce Clause in a manner that displaces the States' exercise of their police powers." Id. at 291 (citations omitted).

In enacting the Parity Act, Congress exercised its plenary Commerce Clause powers. Banking constitutes a recognized form of interstate commerce, United States v. Citizens and S. Nat'l Bank, 422 U.S. 86, 91 (1975), and loans secured by interests in real property constitute a recognized form of banking. Additionally, the legislative history acknowledges that AMT financing "is essential to the maintenance of an adequate supply of housing credit for the Nation. . . ." S. Rep. 97-463, at 54 (1982).

In addition, consumer protection in borrowing and lending is not a area traditionally reserved to the states free of federal regulation. See, e.g. Real Estate Settlement Procedures Act, 12 U.S.C. §§2601 *et seq.*, the Fair Credit Reporting Act, 15 U.S.C. §§ 1681a *et seq.*, the Truth in Lending Act, 15 U.S.C. §§ 1601 *et seq.*, the Fair Debt Collections Practices Act, 15 U.S.C. §§ 1692 *et seq.* These statues provide crucial substantive and legal protections for consumers nationwide in large part because Congress clearly expressed its intent, as it did in the Parity Act, that federal safeguards preempt state law regulating the same subject area. See, e.g., RESPA Reg. X, 24 C.F.R. § 3500.13, 12 U.S.C. foll. § 2617; 15 U.S.C. § 1681t (Fair Credit Reporting Act); 15 U.S.C. § 1610 (Truth in Lending Act); and 15 U.S.C. § 1692n (Fair Debt Collection Practices Act).

Thus, because the borrowing and lending of money is commerce that falls within Congress' broad commerce

power, then this area is not clearly reserved to the states under the Tenth Amendment. Instead, when the power is delegated, as it is here through the Commerce Clause, then the power of Congress is plenary and it can act to the exclusion of laws of the states.

6. Virginia Public Policy

While Virginia's public policy in favor of consumer protection is admirable, the sections of the Virginia Code limiting prepayment penalties cannot be enforced because they are preempted by federal law. Congress has adopted a different policy premised on the belief that consumers are better off if federal standards apply in states that did not opt out of the Parity Act between 1982 and 1985. 12 U.S.C. § 3801(a)(2). Further, Congress' less paternalistic policy is meant to benefit consumers instead of limiting their options. Rather than limiting the amount of credit available to consumers, the federal regime permits additional credit to be available to consumers in accordance with market regulation, thus giving greater choice and greater credit.

III. CONCLUSION

For all of these reasons, the Court grants plaintiff's motion for summary judgment and denies both SCC defendants' and the Attorney General's motions for summary judgment. The Court permanently enjoins defendants from enforcing their announced position that the Parity Act does not preempt Virginia state law limiting prepayment penalties on alternative mortgage transactions.

An appropriate Order shall issue.

Sep 10 1999 /s/ Richard L. Williams

DATE SENIOR UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Richmond Division

NATIONAL HOME EQUITY MORTGAGE ASSOCIATION, Plaintiff, v. E. JOSEPH FACE, JR., Commissioner of Financial Institutions, Bureau of Financial Institutions, Virginia State Corporation Commission, SUSAN E. HANCOCK, Deputy Commissioner, Consumer Finance, Bureau of Financial Institutions, Virginia State Corporation Commission Defendants, MARK L. EARLEY, Attorney General of Virginia Intervenor-Defendant.	Civil Action Number 3:99cv398

ORDER

For the reasons stated in the accompanying Memorandum Opinion, the Court GRANTS plaintiff's motion for summary judgment, DENIES SCC defendants' motion for summary judgment, and DENIES the Attorney General, Intervenor-Defendant's motion for summary

judgment. The Court permanently ENJOINS defendants from enforcing their announced position that the Parity Act does not preempt Virginia state law limiting prepayment penalties on alternative mortgage transactions.

It is so ORDERED.

Let the Clerk send a copy of this Order and the accompanying Memorandum Opinion to all counsel of record.

Sep 10 1999
DATE

/s/ Richard L. Williams
SENIOR UNITED STATES DISTRICT JUDGE

UNITED STATES DISTRICT COURT

---------Eastern ---------- DISTRICT OF-------- Virginia-------
Richmond Division

National Home Equity Mortgage Association,

Plaintiff,

v.

E. Joseph Face, Jr., et al.,

JUDGMENT IN A CIVIL CASE

Case number:
3:99CV398

Defendants.

☐ **Jury Verdict.** This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

☒ **Decision by Court.** *This action came to a hearing before the Court. The issues have been heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that the Court GRANTS plaintiff's motion for summary judgment, DENIES SCC defendants' motion for summary judgment, and DENIES the Attorney General, Intervenor-Defendant's motion for summary judgment. The Court permanently ENJOINS defendants from enforcing their announced position that the Parity Act does not preempt Virginia state law limiting prepayment penalties on alternative mortgage transactions.

September 10, 1999
Date

Norman H. Meyer, Jr.
Clerk

/s/
(By) Deputy Clerk

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF VIRGINIA
Richmond Division

NATIONAL HOME EQUITY MORTGAGE ASSOCIATION

Plaintiff,

v. Case No.: 3:99cv398

E. JOSEPH FACE, JR. and SUSAN E. HANCOCK,

Defendants.

NOTICE OF APPEAL

Notice is hereby given that the defendants, E. Joseph Face, Jr., and Susan E. Hancock, hereby appeal to the United States Court of Appeals for the Fourth Circuit from the final judgment of the United States District Court for the Eastern District of Virginia entered in this action on the 10th day of September 1999.

E. JOSEPH FACE, JR.
SUSAN E. HANCOCK

BY: /s/ Robert A. Dybing, Jr.
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NATIONAL HOME EQUITY MORTGAGE ASSOCIATION,
Plaintiff-Appellee,

v.

MARK L. EARLEY,
Defendant-Appellant,

and

E. JOSEPH FACE, JR., Commissioner of Financial Institutions, Bureau of Financial Institutions, Virginia State Corporation Commission; SUSAN E. HANCOCK, Deputy Commissioner, Consumer Finance, Bureau of Financial Institutions, Virginia State Corporation Commission,
Defendants.

No. 99-02386

Appeals from the United States District Court
for the Eastern District of Virginia, at Richmond.
Richard L. Williams, Senior District Judge.
(CA-99-398-3)

Argued: October 30, 2000

Decided: February 7, 2001

Before NIEMEYER and LUTTIG, Circuit Judges, and
Alexander WILLIAMS, Jr., United States District Judge
for the District of Maryland, sitting by designation.

Affirmed by published opinion. Judge Niemeyer wrote the opinion, in which Judge Luttig and Judge Williams joined.

COUNSEL

ARGUED: Robert A. Dybing, SHUFORD, RUBIN & GIBNEY, Richmond, Virginia, for Appellants. Earle Duncan Getchell, Jr., MCGUIRE, WOODS, BATTLE & BOOTHE, L.L.P., Richmond, Virginia, for Appellee. **ON BRIEF**: James C. Dimitri, William F. Schutt, STATE CORPORATION COMMISSION OF VIRGINIA, Richmond, Virginia; Martha B. Brissette, OFFICE OF THE ATTORNEY GENERAL OF VIRGINIA, Richmond, Virginia, for Appellants. Robert L. Hodges, William H. Baxter, II, MCGUIRE, WOODS, BATTLE & BOOTHE, L.L.P., Richmond, Virginia, for Appellee.

OPINION

NIEMEYER, Circuit Judge:

We must decide whether a non-federally chartered housing creditor in Virginia may, by complying with the Alternative Mortgage Transaction Parity Act of 1982, include in a home loan agreement an obligation to pay a prepayment fee that exceeds the limits imposed by Virginia Code §§ 6.1-330.83 and 6.1-380.85. For the reasons that follow, we hold that, subject to the non-federally chartered lender's compliance with federal law, it may charge a prepayment fee, despite any limitation imposed by the Virginia Code, because in that circumstance the federal law

preempts state law by virtue of § 804(c) of the Parity Act, 12 U.S.C. § 3803(c). Accordingly, we affirm the district court's judgment reaching the same conclusion.

I

The late 1970s and early 1980s witnessed an alarming deterioration in the number of home mortgage lending institutions — "housing creditors" — in part because of their inability to adjust their long-term mortgage portfolios to the high and widely fluctuating short-term deposit interest rates. In response, Congress enacted the Garn-St. Germain Depository Institutions Act of 1982 "to revitalize the housing industry by strengthening the financial stability of home mortgage lending institutions and ensuring the availability of home mortgage loans." Pub. L. No. 97-320, 96 Stat. 1469 (1982). Title VIII of that act, titled the "Alternative Mortgage Transaction Parity Act of 1982" (the "Parity Act"), was included to "authorize[ ] non-federally chartered housing creditors to offer alternative mortgages in accordance with the Federal regulations issued by the appropriate Federal regulatory agencies. Thus, those creditors will have parity with federally chartered institutions." Sen. Conf. Rep. No. 97-641, at 94 (1982), *reprinted in* 1982 U.S.C.C.A.A.N. 3128, 3137; *see also* 12 U.S.C. § 3801(b). "Alternative mortgages" were understood to refer to those mortgages in which interest rates could be adjusted or renegotiated, in which the maturity date could be shortened, or which included other variations "not common to traditional fixed-rate, fixed-term transactions." Parity Act, § 803(1), 12 U.S.C. § 3802(1).

The practical effect of the statutory scheme is to permit a non-federally chartered housing creditor to make a loan either under state law, in which case the loan transaction remains subject to the full range of state regulations, or under

federal law, in which case the loan transaction becomes subject to federal regulations governing similar loans by federally chartered lending institutions. Non-federally chartered housing creditors exercise this regulatory "option" by affirmatively complying with substantive federal regulations identified by the Office of Thrift Supervision. In return for exercising this option, the non-federally chartered housing creditor is promised parity with federally chartered lenders. *See* 12 U.S.C. § 3803. As the Senate Report relevant to the Act observes, the Parity Act "does not place non-federally chartered housing creditors under the supervision of the federal agencies, but instead merely enables them to follow a federal program as an alternative to state law." S. Rep. No. 97-463, at 55 (1982).

In April 1999, *The Compliance Connection*, the official newsletter of Virginia's State Corporation Commission, announced its position that the Parity Act did not preempt Virginia statutory law limiting prepayment penalties. The newsletter explained that "Congress explicitly restricted the [Office of Thrift Supervision's] authority to preemption of only such state laws as related to features '. . . not common to traditional fixed-rate, fixed-term transactions . . . .' The Virginia statutes applicable to prepayment penalties . . . govern a longstanding feature of conventional mortgage lending which Congress left to state law . . . ." The newsletter announced that the Bureau of Financial Institutions "will continue to cite violations of Virginia statutes relating to prepayment penalties." It noted that licensees would have to notify borrowers of Virginia's prepayment penalty limits and to refund prepayment penalties. The letter also stated, "In addition to possible revocation of license, such violations can be referred to the Attorney General's office for investigation pursuant to Virginia Code § 6.1-430."

In response to this announcement from Virginia officials, the National Home Equity Mortgage Association, a trade association that includes as members non-federally chartered housing creditors, commenced this action seeking a declaratory judgment and an injunction prohibiting Virginia officials from enforcing Virginia' prepayment penalty provisions for loans made under the Parity Act. After the Attorney General for the Commonwealth of Virginia intervened, the district court, on cross-motions for summary judgment, entered judgment in favor of the Mortgage Association and permanently enjoined Virginia officials "from enforcing their announced position that the Parity Act does not preempt Virginia state law limiting prepayment penalties on alternative mortgage transactions." This appeal followed.

II

Virginia argues principally that the scope of preemption effected by the Parity Act does not preclude it from regulating prepayment penalties in alternative mortgage transactions. It argues,

> [S]tate laws that do not prevent or interfere with [alternative mortgage transactions] are not preempted. Congress defined [alternative mortgage transactions] in § 3802(1) to be loans involving terms "not common to traditional fixed-rate, fixed-term transactions." Prepayment penalties were obviously not included in this definition, because they were and are common to traditional real estate financing. Hence, because the Virginia Statutes do not interfere with the making of [alternative mortgage transactions], they are not preempted.

To decide whether the Parity Act preempts Virginia's statutes regulating prepayment penalties, we must first identify the basic principles of preemption that are applicable.

The Supremacy Clause of the United States Constitution mandates that "the Laws of the United States . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const. art. VI, cl. 2. Thus, "federal legislation, if enacted pursuant to Congress' constitutionally delegated authority, can nullify conflicting state or local actions." *Worm v. American Cyanamid Co.*, 970 F.2d 1301, 1304-05 (4th Cir. 1992). "Consideration of issues arising under the Supremacy Clause 'start[s] with the assumption that the historic police powers of the States [are] not to be superseded by . . . Federal Act unless that [is] the clear and manifest purpose of Congress.'" *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 516 (1992) (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947) (alterations in original)). The "ultimate touchstone" of preemption analysis is the intent of Congress. *Malone v. White Motor Corp.*, 435 U.S. 497, 504 (1978). Even when Congress' intent is unclear, state law must nevertheless yield when it conflicts with federal law. In making the determination of whether state law conflicts with federal law, the test to apply is whether "it is impossible to comply with both state and federal law" or whether "the state law stands as an obstacle to the accomplishment of the full purposes and objectives" of the relevant federal law. *Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238, 248 (1984); *see also Feikema v. Texaco, Inc.*, 16 F.3d 1408, 1413 (4th Cir. 1994).

In enacting the Parity Act, Congress clearly intended to preempt state law to the extent it authorized non-federally chartered housing creditors to take advantage of the federal regulations for alternative mortgage transactions that govern federally chartered lending institutions.* Section 802(a)(3) of the Parity Act states that the Office of Thrift Supervision ("OTS"), formerly known as the Federal Home Loan Bank Board, as well as other agencies, "have recognized the importance of alternative mortgage transactions and have adopted regulations authorizing federally chartered depository institutions to engage in alternative mortgage financing." 12 U.S.C. § 3801(a)(3). And § 3801 continues, "It is the purpose of this title to eliminate the discriminatory impact that those regulations have upon nonfederally chartered housing creditors and provide them with parity with federally chartered institutions by authorizing all housing creditors to make ... alternative mortgage transactions so long as the transactions are in conformity with the regulations issued by the Federal agencies." *Id.* § 3801(b).

The operative language of the Parity Act, contained in 12 U.S.C. § 3803, provides that state-chartered deposit institutions and other non-federally chartered housing creditors "may make ... alternative mortgage transactions" to the extent that they are "made in accordance with [federal]

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* The Office of Thrift Supervision has used the rule-making authority conferred on it by §§ 4(a) and 5(a) of the Home Owners Loan Act ("HOLA"), 12 U.S.C. §§ 1463(a)(2), 1464(a), to permit federally chartered thrifts to charge prepayment penalties as specified in the lending documents, regardless of whether the loan is a traditional fixed-interest loan or an alternative mortgage transaction. *See* 12 C.F.R. §§ 560.2(b)(5), 560.34. Virginia does not contend that *federally* chartered institutions must comply with state limitations on prepayment penalties.

regulations governing alternative mortgage transactions . . . for federally chartered savings and loan associations" and that the regulations are legally issued by the OTS or other relevant agency. *Id.* § 3803(a)(3). And critically, the same section provides that a non-federally chartered housing creditor may make an alternative mortgage transaction pursuant to applicable federal regulations "notwithstanding any State constitution, law, or regulation." *Id.* § 3803(c). Thus, to the extent that a non-federally chartered housing creditor makes a loan in compliance with federal regulations for alternative mortgage transactions, it may do so despite contrary state law.

The particular issue presented in this case is whether a non-federally chartered institution in Virginia may require and enforce a prepayment fee in a mortgage agreement notwithstanding Virginia's limitation on prepayment penalties as contained in Virginia Code §§ 6.1-330.83 and 6.1-330.85. The resolution of this issue depends on whether the OTS has issued regulations authorizing prepayment fees as part of its regulations for alternative mortgage transactions, because if it has authorized the collection of prepayment fees in alternative mortgage transactions, then Virginia may not apply its law proscribing such prepayment fees if the non-federally chartered housing creditor has otherwise complied with the requirements of the Parity Act. Although a non-federally chartered lender could, under federal law, forego charging a prepayment fee and thereby comply with Virginia law, to deny the lender the right to make that election by prohibiting it from charging a fee in excess of Virginia's caps would frustrate the federal law's purpose of giving the state-chartered lender parity with the federally chartered lender and therefore would conflict with federal law. *See Silkwood*, 464 U.S. at 248.

Because it is undisputed that federally chartered thrifts are authorized by federal law to charge prepayment penalties by contract, the narrow question we must answer is whether the regulation of prepayment penalties is part and parcel of the federal regulations governing alternative mortgage transactions. Here, history is a persuasive indicator.

Prior to the enactment of the Parity Act, the Federal Home Loan Bank Board, the predecessor to the OTS, had adopted several regulations governing alternative mortgage transactions. Not only did these regulations permit rate adjustments, balloon payments, and other variations in interest and amortization rates, but they also regulated the prepayment of interest by prohibiting a prepayment penalty unless the loan agreement included: "(1) a prepayment penalty, (2) an interest rate that, after loan closing and after any interest-rate adjustment remains fixed for a period of at least five years, and (3) only such increases in the loan balance as a result from the deferral and capitalization of interest pursuant to § 545.6-2(a)(2)(iv) of this Part." 12 C.F.R. § 545.8-5(b) (1983). This regulation also placed a limit on the size of a prepayment penalty that could be collected. In providing notice of this regulation, first promulgated in August 1982, the Federal Home Loan Bank Board stated:

> The proposed amendments would have permitted the imposition of a penalty for the prepayment of all or any part of a loan only if the loan carried a fixed interest rate and permitted no adjustments except to the loan balance resulting from the deferral and capitalization of interest. The Board's previous *alternative mortgage instrument regulations* . . . required associations to permit

> borrowers to prepay such loans in whole or in part at any time without penalty.
>
> The final regulation retains the proposed amendments with one change. Associations will be permitted to impose a prepayment penalty if the loan contract provides that, after loan closing and after each interest rate adjustment, the interest rate remains fixed for a period of at least five years.

Home Loan Amendments, 47 Fed. reg. 36,612, 36,615 (Aug. 23, 1982) (summary of contents) (emphasis added). This explanation provided by the Board in connection with its 1982-83 regulations clearly places the regulation of prepayment penalties within the regulation of "alternative mortgage instruments."

In its current federal regulation, OTS continues to regulate prepayment penalties as part of the alternative mortgage transaction regulations. Section 560.220, entitled "Alternative Mortgage Parity Act," provides that non-federally chartered housing creditors

> may make alternative mortgage transactions as defined by [12 U.S.C. § 3803] and further defined and described by applicable regulations identified in this section, notwithstanding any state constitution, law, or regulation. In accordance with section 807(b) of Public Law 97-320, 12 U.S.C. § 3801 note, §§ 560.33 [Late charges], 560.34 *[Prepayments]*, 560.35 [adjustments to home loans], and 560.210 [Disclosures for variable rate transactions] of this part are identified as

> appropriate and applicable to exercise of this authority and all regulations not so identified are deemed inappropriate and inapplicable.

12 C.F.R. § 560.220 (emphasis added).

Thus, the Parity Act and the regulations, to which it explicitly refers, provide that when a non-federally chartered housing creditor elects to be governed by federal law and complies with that law, it may charge a contractually specified prepayment fee as authorized by federal law, despite the fact that Virginia law provides otherwise. Any other rule would contradict the explicit language of 12 U.S.C. § 3803(c) which provides that "[a]n alternative mortgage transaction may be made by a housing creditor in accordance with this section, notwithstanding any State constitution, law, or regulation." It would also deny the non-federally chartered housing creditor parity with federal institutions when entering into alternative mortgage transactions.

Virginia argues that the definition of an alternative mortgage transaction in 12 U.S.C. § 3802(1) is limited to transactions with terms that are "not common to traditional fixed-rate, fixed-term transactions" and therefore does not include transactions involving prepayment penalties because such penalties *are* common to fixed-rate loans. That clause, however, refers to the essential nature of an alternative mortgage as including variable rates of interest or amortization. It does not specify the terms that such a transaction may or may not include or what regulations may apply. Most importantly, it does not limit the scope of the preemptive force of § 3803(c). That scope is defined in § 3803, which provides that non-federally chartered housing creditors "may make . . . alternative mortgage transactions" as defined in § 3802(1), and that if they do, they must be

made "in accordance with regulations governing alternative mortgage transactions as issued by the Director of the Office of Thrift Supervision for federally chartered savings and loan associations." *Id.* § 3803(a)(3). And, defining the scope of preemption, subsection (c) provides that a loan made *within the scope of such regulations* may be made despite a conflicting state provision. It is undisputed that the regulations for making alternative mortgage transactions not only regulate the prepayment of interest, but also explicitly authorize the collection of prepayment penalties if they are agreed to in the loan agreement. *See* 12 C.F.R. §§ 560.34, 560.220.

Virginia also argues that the federal agencies' imperfect implementation of § 807(b) of the Parity Act indicates the lack of relevance of federal prepayment regulations to alternative mortgage transactions. Section 807(b) provides that the Federal Home Loan Bank Board, as well as other agencies, are required to "publish those portions or provisions of their respective regulations *that are inappropriate for* (and thus inapplicable to), *or that need to be conformed for the use of*, the non-federally chartered housing creditors to which their respective regulations apply." 12 U.S.C. § 3801 note (emphasis added). The Federal Home Loan Bank Board's implementation of § 807(b) published the regulations that were applicable, rather than those inapplicable as directed by the statute, and then it omitted its regulation of prepayment penalties. Virginia argues that this omission indicates that prepayment penalty regulations are not intended to be part of the alternative mortgage transaction regulations.

First, it must be noted that current regulations implementing § 807(b) do not omit prepayment penalty regulations from the list of regulations applicable to alternative mortgage transactions. *See* 12 C.F.R. § 560.220.

Second, Virginia can derive little benefit from the original omission. Section 807(b) is not a provision that defines the scope of federal preemption. Rather, it defines the gate through which the non-federally chartered housing creditors must pass in order to obtain the benefits of the Parity Act. If a state lender conforms to the regulations listed in the regulation implementing § 807(b), then it will enjoy the preemptive protection that the Act grants in 12 U.S.C. § 3803(c). Accordingly, the implementation of § 807(b) provides Virginia with little support.

Finally, Virginia argues that the OTS was without authority to adopt 12 C.F.R. § 560.220 because 12 U.S.C. § 3803(a) is not an authorizing provision, but rather presumes the preexistence of regulations. Any regulation referred to in § 3803, it argues, must be authorized elsewhere. Again, this argument misconstrues the role of 12 C.F.R. § 560.220. That regulation was not authorized by § 3803(a), but by the Home Owners' Loan Act ("HOLA"), 12 U.S.C. § 1461 *et seq.*, and it was adopted pursuant to HOLA as directed by § 807(b) of the Parity Act, which instructs non-federally chartered institutions how to take advantage of the Parity Act. The regulations referred to in § 3803(a) were indeed adopted originally by the Federal Home Loan Bank Board and later by the OTS and other implicated agencies pursuant to their authorizing statutes. In the case of the OTS, the regulations were adopted explicitly under HOLA, as authorized pursuant to 12 U.S.C. §§ 1463(a)(2) and 1464(a); *see also* 12 C.F.R. §§ 560.1, 560.2 (generally drawing on 12 U.S.C. § 1462 *et seq.* for authority to adopt regulations involving alternative mortgage transactions). Thus, we reject Virginia's argument challenging 12 C.F.R. § 560.220.

In sum, we hold that non-federally chartered housing creditors in Virginia — as they are defined in 12 U.S.C.

§ 3802(2) — may elect to have their alternative mortgage transactions governed by the federal law applicable to federally chartered housing creditors engaging in similar transactions by complying with that law, and when they do, that law, which includes 12 C.F.R. § 560.34 (regulating prepayments and authorizing a prepayment fee), preempts Virginia Code §§ 6.1-330.83 and 6.1-330.85, which limits the imposition of prepayment penalties. This conclusion is required by 12 U.S.C. § 3803 and is clearly consistent with the *raison d'etre* of the Parity Act — giving State-chartered lending institutions parity with federally chartered lending institutions. *See* 12. U.S.C. § 3801(b).

For the foregoing reasons, the judgment of the district court is

AFFIRMED.

PUBLIC LAW 97-320; October 15, 1982

GARN-ST GERMAIN DEPOSITORY INSTITUTIONS ACT OF 1982

An act to revitalize the housing industry by strengthening the financial stability of home mortgage lending institutions and ensuring the availability of home mortgage loans.

Title I: Deposit insurance flexibility
Title II: Capital assistance
Title III: Thrift institutions restructuring
Title IV: Provisions affecting national and member banks
Title V: Amendment to the Federal Credit Union Act
Title VI: Bank holding company insurance activities
Title VII: Miscellaneous

TITLE VIII-ALTERNATIVE MORTGAGE TRANSACTIONS

SHORT TITLE

SEC. 801. This title may be cited as the "Alternative Mortgage Transaction Parity Act of 1982".

(Codified as 12 U.S.C. 3801, note.)

FINDINGS AND PURPOSE

SEC. 802. (a) The Congress hereby finds that —

(1) increasingly volatile and dynamic changes in interest rates have seriously impared [sic] the ability of housing creditors to provide consumers with fixed-term, fixed-rate credit

secured by interests in real property, cooperative housing, manufactured homes, and other dwellings;

(2) alternative mortgage transactions are essential to the provision of an adequate supply of credit secured by residential property necessary to meet the demand expected during the 1980's; and

(3) the Comptroller of the Currency, the National Credit Union Administration, and the Federal Home Loan Bank Board have recognized the importance of alternative mortgage transactions and have adopted regulations authorizing federally chartered depository institutions to engage in alternative mortgage financing.

(b) It is the purpose of this title to eliminate the discriminatory impact that those regulations have upon nonfederally chartered housing creditors and provide them with parity with federally chartered institutions by authorizing all housing creditors to make, purchase, and enforce alternative mortgage transactions so long as the transactions are in conformity with the regulations issued by the Federal agencies.

(Codified as 12 U.S.C. 3801.)

DEFINITIONS

SEC. 803. As used in this title—

(1) the term "alternative mortgage transaction" means a loan or credit sale secured by interest in residential real property, a dwelling, all stock allocated to a dwelling unit in a residential cooperative housing corporation, or a residential

manufactured home (as that term is defined in section 603(6) of the National Manufactured Home Construction and Safety Standards Act of 1974)—

(A) in which the interest rate or finance charge may be adjusted or renegotiated;

(B) involving a fixed-rate, but which implicitly permits rate adjustments by having the debt mature at the end of an interval shorter than the term of the amortization schedule; or

(C) involving any similar type of rate, method of determining return, term, repayment, or other variation not common to traditional fixed-rate, fixed-term transactions, including without limitation, transactions that involve the sharing of equity or appreciation;

described and defined by applicable regulation; and

(2) the term "housing creditor" means—

(A) a depository institution, as defined in section 501(a)(2) of the Depository Institutions Deregulation and Monetary Control Act of 1980;

(B) a lender approved by the Secretary of Housing and Urban Development for participation in any mortgage insurance program under the National Housing Act;

(C) any person who regularly makes loans, credit sales, or advances secured by

interests in properties referred to in paragraph (1); or

(D) any transferee of any of them.

A person is not a "housing creditor" with respect to a specific alternative mortgage transaction if, except for this title, in order to enter into that transaction, the person would be required to comply with licensing requirements imposed under State law, unless such person is licensed under applicable State law and such person remains, or becomes, subject to the applicable regulatory requirements and enforcement mechanisms provided by State law.

(Codified as 12 U.S.C. 3802.)

ALTERNATIVE MORTGAGE AUTHORITY

SEC. 804. (a) In order to prevent discrimination against State-chartered depository institutions, and other nonfederally chartered housing creditors, with respect to making, purchasing, and enforcing alternative mortgage transactions, housing creditors may make, purchase, and enforce alternative mortgage transactions, except that this section shall apply—

(1) with respect to banks, only to transactions made in accordance with regulations governing alternative mortgage transactions as issued by the Comptroller of the Currency for national banks, to the extent that such regulations are authorized by rulemaking authority granted to the Comptroller of the Currency with regard to national banks under laws other than this section;

(2) with respect to credit unions, only to transactions made in accordance with regulations governing alternative mortgage transactions as issued by the National Credit Union Administration Board for Federal credit unions, to the extent that such regulations are authorized by rulemaking authority granted to the National Credit Union Administration with regard to Federal credit unions under laws other than this section; and

(3) with respect to all other housing creditors, including without limitation, savings and loan associations, mutual savings banks, and savings banks, only to transactions made in accordance with regulations governing alternative mortgage transactions as issued by the Federal Home Loan Bank Board for federally chartered savings and loan associations, to the extent that such regulations are authorized by rulemaking authority granted to the Federal Home Loan Bank Board with regard to federally chartered savings and loan associations under laws other than this section.

(b) For the purpose of determining the applicability of this section, an alternative mortgage transaction shall be deemed to be made in accordance with the applicable regulation notwithstanding the housing creditor's failure to comply with the regulation, if—

(1) the transaction is in substantial compliance with the regulation; and

(2) within sixty days of discovering any error, the housing creditor corrects such error,

including making appropriate adjustments, if any, to the account.

(c) An alternative mortgage transaction may be made by a housing creditor in accordance with this section, notwithstanding any State constitution, law, or regulation.

(Codified as 12 U.S.C. 3803)

APPLICABILITY

SEC. 805. (a) The provisions of section 804 shall not apply to any alternative mortgage transaction in any State made on or after the effective date (if such effective date occurs on or after the effective date of this title and prior to a date three years after the effective date of this title) of a State law or a certification that the voters of such State have voted in favor of any provision, constitutional or otherwise, which states explicitly and by its terms that such State does not want the preemption provided in section 804 to apply with respect to alternative mortgage transactions subject to the laws of such State, except that section 804 shall continue to apply to—

(1) any alternative mortgage transaction undertaken on or after such date pursuant to an agreement to undertake such alternative mortgage transaction which was entered into on or after the effective date of this title and prior to such later date (the "preemption period"); and

(2) any renewal, extension, refinancing, or other modification of an alternative mortgage transaction that was entered into during the preemption period.

(b) An alternative mortgage transaction shall be deemed to have been undertaken during the preemption period to which this section applies if it—

(1) is funded or extended in whole or in part during the preemption period, regardless of whether pursuant to a commitment or other agreement therefor made prior to that period; or

(2) is a renewal, extension, refinancing, or other modification of an alternative mortgage transaction entered into before the preemption period and such renewal, extension, or other modification is made during such period with the written consent of any person obligated to repay such credit.

(Codified as 12 U.S.C. 3804.)

RELATION TO OTHER LAW

SEC. 806. Section 501(c)(1) of the Depository Institutions Deregulation and Monetary Control Act of 1980 shall not apply to transactions which are subject to this title.

(Codified as 12 U.S.C. 3805.)

EFFECTIVE DATE

SEC. 807. (a) This Title shall be effective upon enactment.

(b) Within sixty days of the enactment of this title, the Comptroller of the Currency, the National Credit Union Administration, and the Federal Home Loan Bank Board shall identify, describe, and publish those portions or

provisions of their respective regulations that are inappropriate for (and thus inapplicable to), or that need to be conformed for the use of, the nonfederally chartered housing creditors to which their respective regulations apply, including without limitation, making necessary changes in terminology to conform the regulatory and disclosure provisions to those more typically associated with various types of transactions including credit sales.

(Codified as 12 U.S.C. 3801, note.)

Approved October 15, 1982.

FEDERAL REGISTER (excerpts) 47 FR 51732
November 17, 1982

FEDERAL HOME LOAN BANK BOARD

12 CFR PART 545

. . . .

Interim Implementation of Powers; Housing Creditors Regarding Alternative Mortgage Transactions

. . . .

SUMMARY: . . . The Board also is providing the notice required by title VIII of the Act regarding federal preemption of state law governing alternative mortgage transactions in order to give housing creditors the ability to make a greater variety of mortgage loans.

. . . .

Notice to Housing Creditors Regarding Alternative Mortgage Transaction

Title VIII of the Act authorizes non-federally-chartered housing creditors to offer alternative mortgage instruments in accordance with regulations issued by federal regulatory agencies in order to grant parity with federally-chartered lenders. Housing creditors must refer to the regulations of: for commercial banks, the Comptroller of the Currency; for credit unions, the National Credit Union Administration; and for all others, the Federal Home Loan Bank Board. The Act requires the Board to publish notice of its regulations that need to be conformed to by housing creditors in order to take advantage of the preemption of

state law. The Board is taking this opportunity to publish the required notice.

Section 803 of the Act defines "alternative mortgage transactions" to mean:

[a] Loan or credit sale secured by an interest in residential real property, a dwelling, all stock allocated to a dwelling unit in a residential cooperative housing corporation, or a residential manufactured home (as that term is defined in section 603(6) of the National Manufactured Home Construction and Safety Standards Act of 1974)—

(A) In which the interest rate finance charge may be adjusted or renegotiated;

(B) Involving a fixed-rate, but which implicitly permits rate adjustments by having the debt mature at the end of an interval shorter than the term of the amortization schedule; or

(C) Involving any similar type of rate, method of determining return, term, repayment, or other variation not common to traditional fixed-rate, fixed-term transactions, including without limitation, transactions that involve the sharing of equity or appreciation described and defined by applicable regulation.

Board regulations governing loans meeting this definition include the following:

1. *Home Loans*—Housing creditors that are not commercial banks, credit unions or federal associations are authorized to make alternative mortgage loans secured by residential real estate comprising a single family dwelling or dwelling units for four or fewer families in the aggregate,

subject to the limitations contained in 12 CFR 545.6-2(a)(2), (7) (as amended, 47 FR 36612 (August 23, 1982)). A full description of the types of mortgage transactions authorized and the requirements of the regulations is included in the Federal Register publication cited above. Housing creditors should also refer to 12 CFR Part 541 (1982) for definitions of various terms used in the regulations.

2. *Other Residential Real Property Loans*—For all other residential real property loans, housing creditors that are not commercial banks, credit unions or federal associations are authorized to enter into alternative mortgage transactions without restriction on adjustments to rate, payment, balance or term and without required disclosure.

In publishing this notice, the Board has identified regulations authorizing alternative mortgage transactions and the limitations applicable to those transactions. Other regulations designed to ensure safety and soundness in residential real estate lending by federal associations in general have not been identified, and on these matters housing creditors should refer to otherwise applicable state law. The Board, however, solicits the comments of housing creditors regarding any other provisions of Board regulations that would facilitate use of the federal preemption. Because federal associations engage in mortgage lending activities and not credit sales, the Board's regulations use the term "loan" and its derivatives. Housing creditors engaged in credit sales should read the term "loan" as "credit sale" wherever appropriate.

12 CFR PARTS 500 TO 599

CHAPTER V - THE FEDERAL HOME LOAN BANK BOARD

As of January 1, 1983, incorporating the amendments at 47 FR 36620 of Aug. 23, 1982.

PART 545 - OPERATIONS

SAVINGS ACCOUNTS

[Sections 545.1 through 545.5-1 not set out]

REAL ESTATE LOANS

[Sections 545.6, 545.6a, and 545.6-1 not set out]

§ 545.6-2 Other residential real estate loans.

(a) *Home loans*—(1) *Authorization.* A federal association may make, sell, purchase, participate, or otherwise deal in loans on the security of homes or combinations of homes and business property and on farm residences and combinations of farm residences and commercial farm real estate, including nonamortized, partially-amortized, and line-of-credit loans, on which the interest rate, the payment, the loan balance or the term to maturity may vary as provided in this paragraph (a). Such loans shall be repayable in at least semiannual installments over a term not exceeding 40 years, with interest payable at least semiannually except as expressly authorized in this paragraph (a). An association making a home loan shall possess only such rights and powers as are expressly set forth, by incorporation or otherwise, in the loan documents and as are provided by operation of law.

(2) *Adjustments to rate, payment, balance or term; refinancing*. Subject to such limitations on adjustment as are set forth in the loan contract:

(i) Adjustments to the interest rate shall correspond directly to the movement of an interest-rate index or of an index that measures the rate of inflation or the rate of change in consumer disposable income, which index is readily available to and verifiable by the borrower and is beyond the control of the association: *Provided*, that an association may decrease the interest rate at any time;

(ii) Adjustments to the payment and the loan balance that do not reflect an interest-rate adjustment may be made if *(a)* the adjustments reflect a change in a national or regional index that measures the rate of inflation or the rate of change in consumer disposable income, is readily available to and verifiable by the borrower, and is beyond the control of the association, or *(b)* in the case of a payment adjustment, the adjustment reflects a change in the loan balance or is made pursuant to a formula, or to a schedule specifying the percentage or dollar change in the payment and set forth in the contract;

(iii) Any combination of indices or a moving average of index values may be used as an index, and an association may use more than one index during the term of a loan;

(iv) A loan contract may provide for the deferral and capitalization of a portion of interest, and may provide that a portion of the consideration to be received by the association in return for making the loan shall be interest in the form of a percentage of the amount by which the current market value of the property, during the loan term or at maturity, exceeds the original appraised value;

(v) At least 30 but not more than 120 days prior to an adjustment and at least 90 but not more than 120 days prior to the expected maturity of a non-or partially-amortized loan (including a loan with a "call" provision pursuant to paragraph (a)(2)(vi) of this section, an association shall provide the borrower with notice of the adjustment or of maturity. However, where the loan contract provides that changes in the interest rate shall occur more frequently than changes in the payment, the association need not notify the borrower of changes in the rate, nor of changes in the loan balance or term resulting from a rate change, until notice of a payment adjustment is given. (For purposes of notification, a payment adjustment is considered to occur as of the date of the interest-rate change immediately preceding the due date of the adjusted payment.) In addition, where the loan contract sets out a schedule of payment adjustments, notice need not be given of payment changes made pursuant to that schedule;

(vi) The loan term may be adjusted only to reflect a change in the interest rate, the payment or the loan balance. A loan contract may provide an association with the right to call the loan due and payable either after a specified number of years has elapsed following closing or upon the occurrence of a specified event external to the loan; and

(vii) If at maturity of a loan that provides for adjustments pursuant to this paragraph (a)(2) the ratio of the loan balance to the current market value of the security property exceeds 95 percent, the association may offer to refinance the loan, subject to the requirements of subparagraphs (3)(i) and (3)(iii) of this paragraph (a) and other applicable provisions of this part.

[Subsections (a)(3) through (a)(6) of § 545.6-2 omitted]

(7) Disclosure. Prior to accepting an application for a loan, an association must disclose to each loan applicant, in one or more documents other than the loan documents and in plain language, the terms of the type(s) of loan(s) offered to the applicant. The purpose of this disclosure requirement is to ensure full understanding to the operation of the loan for which the individual is applying. The disclosures do not alone constitute a commitment on the part of an association to make a loan to a loan applicant. The disclosure material provided to an applicant shall include at least such of the following information as is relevant to the type of loan being offered:

(i) A general explanation of the fact that *(a)* the association and the applicant become bound by the terms of the loan contract upon signing it, *(b)* even though subsequently either party may request modification of the contract, neither party is bound to agree to such a request, and *(c)* since normally the loan contract and mortgage (or deed of trust) establish the rights of the borrower, the borrower should become familiar with and understand the provisions of those documents;

(ii) The term to maturity;

(iii) The initial interest rate, if known, or the manner in which the initial interest rate will be established;

(iv) The amount of the initial payment, if known, and an explanation of how the association establishes an amortization schedule for the loan, including how the association determines both the amount of each payment and what proportion of each payment is credited to interest.

(v) A full explanation of how the interest rate, the payment, the loan balance, or the term to maturity may be adjusted (including identification of the index(es) to be used and how index values may be obtained by the borrower), and how the adjustment of one item may affect the others;

(vi) What information will be contained in each notice of an adjustment and, in the case of a non- or partially-amortized loan (including a loan giving the association the right to call the loan due and payable after a number of years or upon the occurrence of an event external to the loan), in the notice of maturity, and how far in advance of an adjustment or maturity each notice will be provided;

(vii) A description of all contractual contingencies under which the loan may become due or which may result in a forced sale of the home;

(viii) If the loan is a non- or partially-amortized loan, unless the association unconditionally obligates itself to re-finance the loan, a statement that a large payment will be due at maturity of the loan and that the association is under no obligation to refinance the loan; if the loan gives the association the right to call the loan due and payable after a number of years or upon the occurrence of an event external to the loan, a statement that a large payment may be due at such time and that the association is not obligated to refinance the loan;

(ix) A description of any prepayment penalty provided for by the loan contract;

(x) Whether the loan contract will provide for escrow payments, the purpose of requiring escrow payments,

and how the amount of an escrow payment is established; and

(xi) An example of the interaction of all variable features of the loan over any period of time.

[Subsection 545(a)(8) of § 545.6-2 through Section 545.6-14 not set out]

OTHER LOANS

[Sections 545.7 through 545.7-11 not shown]

GENERAL PROVISIONS RESPECTING LOANS

545.8-2 Initial loan charge [text omitted].

545.8-3 Contract provisions for real estate loans [text omitted].

545.8-4 Servicing of loans [text omitted].

§ 545.8-5 Loan payments.

[Subsection (a) relating to initial payments - text omitted]

(b) Loan payments and prepayments. Payments on the principal indebtedness of all loans on real estate shall be applied directly to reduction of such indebtedness, but prepayments made on an installment loan may be reapplied from time to time wholly or partly to offset payments which subsequently accrue under the loan contract. A borrower on a loan secured by a home or combination of home and business property may prepay the loan without penalty unless the loan contract expressly provides for all of the following: (1) A prepayment penalty, (2) an interest rate

that, after loan closing and after any interest-rate adjustment, remains fixed for a period of at least five years, and (3) only such increases in the loan balance as result from the deferral and capitalization of interest pursuant to § 545.6-2(a)(2)(iv) of this part. The prepayment penalty for a loan secured by a home or combination of home and business property shall not be more than six months' advance interest on that part of the aggregate amount of all prepayments made on such loan in any 12-month period which exceeds 20 percent of the original principal amount of the loan.

[Sections 545.8-6 through the end of the OPERATIONS regulations not set out]

PART 555 - BOARD RULINGS

. . . .

§ 555.15 Prepayment penalty on mortgage loans.

Section 545.8-5(b) makes clear that charging a prepayment penalty is a matter of contract between a Federal association and a borrower, and that the borrower may wholly or partly prepay the loan without penalty unless the loan contract contains an express provision imposing a prepayment penalty. Section 545.8-5(b) also authorizes a Federal association to include a provision in its loan contract with a borrower (who occupies or will occupy the home securing the mortgage loan) imposing a prepayment penalty at any amount up to, but not exceeding, a specified limit. Thus, in view of the controlling Federal regulation, a Federal association may include a prepayment provision in the loan contract up to the maximum limitation of § 545.8-5(b) regardless of conflicting State law which sets a lower limit or imposes a different type of prepayment penalty, but it may

not charge a prepayment penalty exceeding the limit in § 545.8-5(b) even if State law allows a higher charge.

FEDERAL REGISTER (excerpts) 48 FR 23032
May 23, 1983

FEDERAL HOME LOAN BANK BOARD

12 CFR Parts 523, 526, 541, 545, 555, 561, and 563

Implementation of New Powers; Limitation on Loans to One Borrower

. . . .

Supplemental Information

. . . .

Notice to Housing Creditors

Title VIII of the DIA authorizes certain housing creditors to make alternative mortgage transactions, notwithstanding any State constitution, law, or regulation. Section 80.4(a) of the DIA specifies that housing creditors other than banks, credit unions, and Federal associations may make alternative mortgage transactions only in accordance with regulations governing alternative mortgage transactions issued by the Board for federally chartered savings and loan associations. "Alternative mortgage transactions" is defined in section 803(1) to include loans or credit sales secured by residential real property, a dwelling, all stock in a residential cooperative, or a residential manufactured home (1) in which the interest rate finance charge may be adjusted or renegotiated, (2) in which rate adjustments are implicitly permitted by having the debt mature during an interval shorter than the term of amortization, or (3) in which the method of determining return, term, or repayment is not common to traditional fixed-rate, fixed-term transactions.

This definition, however, requires that permissible transactions be described and defined by applicable regulation.

Section 807(b) directs the Board to identify, describe and publish those portions of its regulations that are inappropriate for, and thus inapplicable to, the non-federally chartered housing creditors. On November 17, 1982, the Board published a "Notice to Housing Creditors" (47 FR 51732, 51733), and requested comments thereon. The Notice provided that housing creditors that are not commercial banks, credit unions or federal associations may make alternative mortgage loans secured by a single-family dwelling or dwelling units for four or fewer families, subject to the limitations contained in 12 CFR 545.6-2(a)(2), (7) (as amended, 47 FR 36612 (1982)). These housing creditors would, therefore, comply with the Board requirements on adjustments to rate, payment, balance or term and on disclosure. Requirements concerning loan-to-value ratios and other requirements designed to ensure safety and soundness in residential real estate lending by Federal associations were deemed inappropriate for, and thus inapplicable to, these housing creditors. For all other residential real property loans, all requirements as to adjustments to rate, payment, balance or term, and to disclosures were deemed inappropriate and inapplicable as well.

The Board's approach to the applicability of its regulations is premised on the clear statement of Congressional intent that Title VIII "does not place non-federally chartered housing creditors under the supervision of the federal agencies, but instead merely enables them to follow a federal program as an alternative to state law." S. Rep. No. 97-463, 97th Cong., 2d Sess. 55. The Notice to Housing Creditors should, therefore, identify as appropriate

those regulations that further "describe and define" (section 803(1)) alternative mortgage transactions, and not those regulations intended for the general supervision of Federal associations. Also, those requirements applicable to mortgage lending generally (*i.e.*, fixed-rate, fixed-term, fully amortized loans as well as alternative mortgage transactions) are deemed inappropriate because they do not further "describe or define" alternative mortgage transactions defined in section 803(1) of Pub. L. 97-320.

The comments received on the November 17, 1982 Notice raised a number of issues. Some commenters requested that the Notice be expanded to include references to partially amortized loans, to forty year amortization limitations, to regulations on manufactured home loans, and to loan-to-value requirements.

In responding to these suggestions, the Board adheres to the approach that those regulatory provisions that describe and define alternative mortgage transactions should be deemed applicable, but those provisions that apply generally to mortgage loans, those outside of the authority granted by Title VIII, and those imposed on Federal associations for safety and soundness purposes should not be applied. The revised Notice, therefore, does not include a reference to the forty year amortization limit because this requirement is not one particular to alternative mortgage transactions. The provisions on loan-to-value ratios are not deemed appropriate because they reflect the consideration of safety and soundness in the Board's supervision of Federal associations. References to manufactured home loans or other types of loans are not included in the Notice because section 803(1) clearly defines the types of loans to which the authority to make alternative mortgage transactions is applicable.

The final rule incorporates a revised Notice to Housing Creditors as an Appendix to Part 545. The Board believes that codification of the Notice in this manner will make reference to the applicable regulations easier for housing creditors that must rely on the regulations pursuant to section 804(a)(3). The revised Notice references the basic authority to make alternative mortgage transactions and the statutory definition set forth in section 803. The Notice identifies only the following rules as applicable:

§ 545.33(c), setting forth the authority to make partially amortized or non-amortized loans and to adjust the interest rate, payment, balance, or term to maturity;

§ 545.33(e), setting forth limitations on adjustments to loans secured by borrower-occupied property; and

§ 545.33(f)(4) thru (11), setting forth requirements for disclosures on loans secured by borrower-occupied property that are not fixed-rate and fully amortized.

The Board believes that these provisions are an integral part of, and particular to, alternative mortgage transactions made by Federal associations. The adjustment and disclosure provisions are further limited in applicability to loans secured by borrower-occupied property, and therefore are limited in the same manner for housing creditors other than commercial banks and credit unions. All other regulations are deemed inappropriate and, therefore, inapplicable.

. . . .

Appendix

Notice to Housing Creditors Regarding Alternative Mortgage Transactions.

Pursuant to Title VIII, Pub. L. 97-320, housing creditors that are not commercial banks, credit unions, or Federal associations may make alternative mortgage transactions (as defined by Section 803 of Pub. L. 97-320 and as further defined and described by applicable regulations identified herein) notwithstanding any state constitution, law or regulation. In accordance with Section 807(b) of Pub. L. 97-320, the provisions listed below are identified as appropriate and applicable to the exercise of this authority, and all regulations not identified herein are deemed inappropriate and inapplicable. §§ 545.33(c), (e), and (f) (4)-(11).

(47 FR, at 23076)

12 U.S.C. §1735f-5

§ 1735f-5

(a). . .

(b) For purposes of subsection (a) of this section, the term "federally related mortgage loan" means any loan which—

(1) is secured by residential real property designed principally for the occupancy of from one to four families; and

(2)(A) is made in whole or in part by any lender the deposits or accounts of which are insured by any agency of the Federal Government or is made in whole or in part by any lender which is itself regulated by any agency of the Federal Government; or

(B) is made in whole or in part, or insured, guaranteed, supplemented, or assisted in any way, by the Secretary of Housing and Urban Development or any other officer or agency of the Federal Government or under or in connection with a housing or urban development program administered by the Secretary of Housing and Urban Development or a housing or related program administered by any other such officer or agency; or

(C) is eligible for purchase by the Federal National Mortgage Association, the Government National Mortgage Association, or the Federal Home Loan Mortgage Corporation, or from any financial institution from which it could be purchased by the Federal Home Loan Mortgage Corporation; or

(D) is made in whole or in part by any "creditor," as defined in section 1602(f) of Title 15, who makes or invests in residential real estate loans aggregating more than $1,000,000 per year.

12 U.S.C. § 1735f-7a

§ 1735f-7a.

(a)

(1) The provisions of the constitution or the laws of any State expressly limiting the rate or amount of interest, discount points, finance charges, or other charges which may be charged, taken, received, or reserved shall not apply to any loan, mortgage, credit sale, or advance which is—

(A) secured by a first lien on residential real property, by a first lien on all stock allocated to a dwelling unit in a residential cooperative housing corporation, or by a first lien on a residential manufactured home;

(B) made after March 31, 1980; and

(C) described in section 527(b) of the National Housing Act (12 U.S.C. 1735f-5(b)),. . .

(b)

(1) Except as provided in paragraphs (2) and (3), the provisions of subsection (a)(1) of this section shall apply to any loan, mortgage, credit sale, or advance made in any State on or after April 1, 1980.

(f) The Federal Home Loan Bank Board is authorized to issue rules and regulations and to publish interpretations governing the implementation of this section.

(g) This section takes effect on April 1, 1980.

12 U.S.C. § 1757

§ 1757. Powers

A federal credit union shall have succession in its corporate name during its existence and shall have power— . . .

(5) to make loans, the maturities of which shall not exceed twelve years except as otherwise provided herein, and extend lines of credit to its members, to other credit unions, and to credit union organizations and to participate with other credit unions, credit union organizations, or financial organizations in making loans to credit union members in accordance with the following:

(A) Loans to members shall be made in conformity with criteria established by the board of directors: *Provided*, That— . . .

(viii) a borrower may repay his loan, prior to maturity in whole or in part on any business day without penalty, . . .

§ 6.1-330.37. Certain contracts enforced at rate of interest stated therein; definition of terms for this section and §§ 6.1-330.27:1 and 6.1-330.16— A. Notwithstanding the provisions of §§ 6.1-330.9, 6.1-330.11 and 6.1-330.41 or any other provision relating to interest or usury, contracts made for the loan or forbearance of money, secured or to be secured by a first deed of trust or first mortgage on real estate, or by a first priority security interest in the stock of a residential cooperative housing corporation, may be lawfully enforced as agreed in the obligation of indebtedness or in an agreement signed by the borrower or at the interest rate stated therein on the principal amount loaned or forborne or contracted to be lent or forborne. Disclosure of charges, not otherwise specified in the note, deed of trust or mortgage, in an interest disclosure pursuant to the federal interest disclosure law, shall constitute compliance with this statute.

B. For the purpose of this section and §§ 6.1-330.27:1 and 6.1-330.16:

(ii) in interest rate which varies in accordance with any exterior standard, or which cannot be ascertained from the contract without reference to any exterior circumstances or documents, shall be enforceable as agreed in the obligation of indebtedness or other signed agreement;

C. Notwithstanding any other statute or rule of case law relating to compounding of interest, if regularly scheduled periodic payments on an obligation secured by a first mortgage or first deed of trust are insufficient to pay currently accruing interest on the then principal balance, an agreement in the obligation of indebtedness (or other agreement signed by the borrower), secured thereby,

providing for the addition of such unpaid interest to the principal balance and the future accrual of interest on such balances shall be enforceable as written. (Code 1950, § 6.1-319.1; 1970, c. 38; 1972, c. 857; 1975, c. 448; 1980, c. 708; 1981, c. 588.)

CODE OF FEDERAL REGULATIONS
TITLE 12--BANKS AND BANKING
CHAPTER V--OFFICE OF THRIFT SUPERVISION, DEPARTMENT OF THE TREASURY PART 590--PREEMPTION OF STATE USURY LAWS

§ 590.3 Operation.

(a)

(b)

(c) Nothing in this section preempts limitation in state laws on prepayment charges, attorneys' fees, late charges or other provisions designed to protect borrowers.

THE COMPLIANCE CONNECTION

State Corporation Commission
Bureau of Financial Institutions
Regulatory News for Virginia Mortgage and Consumer Finance Licensees
April 1999

Federal Preemption of Virginia's Prepayment Penalty Laws:

The major topic lately has been the debate over whether the Alternative Mortgage Transaction Parity Act (AMTPA) preempts Virginia laws that place limits on prepayment penalties. The Bureau has received numerous opinion letters from attorneys, along with copies of opinions from the Office of Thrift Supervision's counsel and various states' Attorneys General which opine that the AMTPA preempts Virginia law. The Bureau does not agree with these opinions.

We believe Congress' intention in passing the AMTPA was to authorize, in the case of "housing creditors', the OTS to override state laws which prevented the making of mortgage loans having certain features not common to conventional mortgage loans. We understand the AMTPA gave housing creditors the right to enter into alternative mortgage loan transactions in accordance with OTS regulations only "to the extent that such regulations are authorized by rulemaking authority granted to [the OTS] . . . under laws other than this section (12 U.S.C. §3803)." The prepayment provisions of Virginia law do not prevent or impede creditors from making adjustable rate loans or other non-conventional mortgage loans (balloon, shared equity loans). They never have.

In our opinion, in §3802(1)(c) of the AMTPA, Congress explicitly restricted the OTS's authority to preemption of

only such state laws as related to features "... not common to traditional fixed-rate, fixed-term transactions..." The Virginia statutes applicable to prepayment penalties, §§6.1-330.83 and 6.1-330.85 of the Code of Virginia, govern a longstanding feature of conventional mortgage lending which Congress left to state law under §501(b)(4) of the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA). To express the matter more simply, our view is that federal law governs unconventional features of "alternative mortgage transactions", while state law governs conventional features of such loans, as Congress intended.

In addition, under §501(b)(4) of DIDMCA, the states had an unlimited period of time within which to "opt out" of federal preemption of "points and other charges" connected with federally-related mortgage loans, and no particular formality was required. Virginia opted out as authorized by Congress by amendment and recodification of its money and interest laws in 1987, including statutes related to points, late charges, prepayment penalties, etc. permitted in connection with mortgage loans. Therefore, it was unnecessary to opt out of federal preemption under AMTPA.

Bureau examiners will continue to cite violations of Virginia statues relating to prepayment penalties. Licensees found in violation will be required to refund prepayment penalties collected, in excess of the state law limits. In addition, notification of Virginia's limit on prepayment penalties must be provided to current borrowers so they will be aware that any higher penalty cannot be enforced. A copy of the notification must be made a part of the permanent loan file, and investors who have purchased loans providing for penalties in excess of the penalty set forth in the Virginia Code must also be notified.

In addition to possible revocation of license, such violations can be referred to the Attorney General's office for investigation pursuant to Virginia Code §6.1-430.

Office of Thrift Supervision
Department of the Treasury Chief Counsel
1700 G Street, N.W., Washington, D.C. 20551
(202) 906-6251

April 30, 1996

[Text Omitted]

Re: Effect of Parity Act on Wisconsin Prepayment Penalty Statute

Dear [Text Omitted]:

This responds to your inquiry to [Text Omitted] Office of Thrift Supervision ("OTS"), regarding whether the Alternative Mortgage Transaction Parity Act of 1982 (the "Parity Act"),[1] preempts the application of § 138.056(3)(a) of the Wisconsin Statutes ("Wisconsin Statute")[2] to loans made by Wisconsin-chartered savings and loan associations.[3] The Wisconsin Statute restricts prepayment penalties on variable-rate loans.

In brief, we conclude that variable-rate loans made by Wisconsin-chartered savings and loan associations in conformity with the Parity Act are not subject to the Wisconsin Statute.

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[1] Title VII [sic] of the Garn-St Germain Depository Institutions Act of 1982. Pub. L. No. 97-320, 96 Stat. 1469 (1982), codified at 12 U.S.C.A. § 3801 et seq. (West 1989 & West Supp. 1996).

[2] Wis. Stat. § 138.056(3)(a).

[3] [Text Omitted].

I. Background

The Wisconsin Statute provides:

> A variable rate loan involving a mobile home transaction or using an approved index may be prepaid at any time in whole or in part without penalty. Other variable rate loans may be prepaid in whole or in part without penalty within 30 days after notice of an increase in the interest rate and with the prepayment penalty under § 138.052(2)(a)2 and 3, if prepayment is made before or after the 30-day period.

Section 138.052(2)(a) pertains to prepayment penalties on fixed-rate "residential mortgage loans." Under § 138.052(2)(a)2, penalties are permitted in connection with prepayments made within five years of the date of a loan.[4] Under § 138.052(2)(a)(3), penalties are prohibited with respect to prepayments made five years or more after the date the loan is made. The Wisconsin Statute thus applies the same penalty provisions to variable-rate residential loans tied to a non-approved index as generally apply to fixed-rate residential loans, but carves out a 30-day period after each interest rate adjustment during which any such loan, regardless of its age, may be prepaid without penalty.

An even stricter rule is applied by the Wisconsin Statute to variable-rate residential loans tied to an approved index. Such loans may never be assessed a prepayment penalty.

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[4] Wis. Stat. § 138.052(2)(a)2 also sets forth a formula for determining the maximum penalty permitted with respect to prepayments on residential mortgage loans made within the first five years of the date of a loan.

II. Discussion

The Parity Act authorizes state-chartered depository institutions and other nonfederally chartered "housing creditors" to "make, purchase, and enforce" alternative mortgage transactions without regard to any state constitution, law, or regulation.[5] The Parity Act defines the term "alternative mortgage transaction" to include variable-rate loans secured by residential real estate.[6]

When transactions are undertaken in reliance on the Parity Act, however, they must be made in conformity with regulations governing alternative mortgage transactions issued by the federal banking agencies.[7] State banks and state credit unions lending in reliance on the Parity Act must do so in accordance with regulations governing alternative mortgage transactions issued by, respectively, the Office of the Comptroller of the Currency ("OCC") and the National Credit Union Administration ("NCUA"). All other "housing creditors," including state-chartered savings associations, lending in reliance on the Parity Act must do so in accordance with "regulations governing alternative mortgage

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[5] 12 U.S.C.A. § 3803 (West 1989). There is, however, one exception to the Parity Act's preemption of state law relating to alternative mortgage transactions. The Parity Act gave states three years following its enactment to override, or to "opt out" of, its federal preemption. 12 U.S.C.A. § 3804(a) (West 1989). It is our understanding, based on information you provided to the OTS Central Region, that Wisconsin did not opt out of the Parity Act.

[6] 12 U.S.C.A. § 3802(1) (West 1989).

[7] 12 U.S.C.A. §§ 3801(b), 3803(a) and (c) (West 1989).

transactions as issued by the [OTS]" for federal savings associations.[8]

The question presented is whether a state housing creditor that originates a variable-rate mortgage loan in conformity with the appropriate federal regulations would nevertheless be subject to the prepayment penalty restrictions of the Wisconsin Statute. The preemptive language in the Parity Act reads as follows:

> An alternative mortgage transaction may be made by a housing creditor in accordance with [the Parity Act], notwithstanding any State constitution, law, or regulation.[9]

Beyond this brief statement, the Parity Act provides no explicit guidance regarding the types of state laws Congress intended to preempt. On the one hand, it is clear that certain state laws, such as those governing liens and foreclosure, still apply to loans originated under the Parity Act. State laws of this type apply even when loans are originated by federal thrifts. On the other hand, it is equally clear that a state law prohibiting the issuance of variable-rate loans would be preempted by the Parity Act. The Wisconsin Statute falls somewhere in between these two examples in its potential impact on alternative mortgage loans.

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[8] 12 U.S.C.A. § 3803(a)(3) (West 1989). The Parity Act "does not place non-federally chartered housing creditors under the supervision of the federal agencies, but instead merely enables them to follow a federal program as an alternative to state law. S. Rep. No. 97-463, 97th Cong., 2d Sess. 55, 48 Fed Reg. 23032, 23053 (May 23, 1983); see also 49 Fed Reg. 43040, 43043 (October 26, 1984).

[9] 12 U.S.C.A. § 3803(c) (West 1989).

For guidance as to whether the Wisconsin Statute is one Congress intended to preempt, we believe it is appropriate to look to the purposes that underlie the Parity Act. The Parity Act expressly states that Congress wished to "prevent discrimination against State-chartered depository institutions and other nonfederally chartered housing creditors, with respect to making, purchasing and enforcing alternative mortgage transactions. . . ."[10] At the time the Parity Act was enacted, federally-chartered depository institutions had already been authorized to engage in alternative mortgage transactions under regulations adopted by the federal banking agencies. The parity Act states that:

> It is the purpose of this [Act] to eliminate the discriminatory impact that those [federal] regulations have upon nonfederally chartered housing creditors and provide them with parity with federally chartered institutions by authorizing all housing creditors to make, purchase, and enforce alternative mortgage transactions so long as the transactions are in conformity with the regulations issued by the Federal agencies.[11]

Under OTS regulations, federal thrifts are permitted to impose prepayment penalties at any time and in any amount authorized by their loan contracts.[12] For these

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[10] 12 U.S.C.A. § 3803(a) (West 1989).

[11] 12 U.S.C.A. § 3801(b) (West 1989).

[12] 12 C.F.R. §§ 545.34(c) and 556.11. The Parity Act directs the OTS, OCC, and NCUA to identify which of their lending regulations do not apply to housing creditors making loans under the Parity Act. Section 807(b) of Pub. L. 97-320, 12 U.S.C.A. § 3801 note. In § 545.33(f) of its regulations, the OTS has identified those OTS regulations that apply to housing creditors and has indicated that no other OTS regulations apply. The OTS's prepayment penalty regulations are

purposes, no distinction is drawn between variable-rate and fixed-rate mortgage loans. Thus, unlike lenders operating under the Wisconsin Statute, federal thrifts are not required to provide a 30-day window after each interest rate adjustment within which borrowers may prepay variable-rate loans without penalty, nor are federal thrifts prohibited form imposing prepayment penalties after the fifth anniversary of the origination of the loan.

If state housing creditors were required to follow the Wisconsin Statute when making variable-rate mortgage loans, they would clearly be disadvantaged vis-à-vis federal thrifts -- the very result Congress intended to prevent. The Wisconsin Statute thus appears to fall within the scope of laws preempted by the Parity Act. Accordingly, state savings associations and state housing creditors that are not state banks or credit unions and that originate variable-rate loans in conformity with all applicable OTS regulations need not comply with the Wisconsin Statute.

In reaching the foregoing conclusions, we have relied upon, among other things, the materials you submitted to the OTS Central Region. Our conclusions depend upon the accuracy and completeness of the information contained in such materials, as summarized herein.

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not included in the list of applicable restrictions. Recently, the OTS issued a proposed rulemaking that would expressly incorporate the prepayment penalty regulations. 61 Fed. Reg. 1162, 1179 and 1181 (Jan. 17, 1996) (to be codified as 12 C.F.R. §§ 560.34(b) and 560.210). This is not a substantive change, but is being proposed to eliminate possible confusion. The Parity Act operates to preempt the Wisconsin Statute, leaving housing creditors free to impose prepayment penalties as provided in their loan contracts, unless restricted by OTS regulations. The practical effect of incorporating OTS's permissive prepayment penalty provisions will be to confirm that no OTS restriction was intended by the omission of such provisions from § 545.33(f).

If you have any questions regarding the foregoing, please contact Evelyne Bonhomme, Counsel (Banking and Finance), at (202) 906-7052.

Very truly yours.

/s/ Carolyn J. Buck
Carolyn J. Buck
Chief Counsel

cc: All Regional Directors
All Regional Counsel

FEDERAL REGISTER (excerpts) 61 FR 50951
September 30, 1996

OFFICE OF THRIFT SUPERVISION

12 CFR Parts 545, 556, 560, 563, 566, 571, 590

Lending and Investment

. . . .

ACTION: Final Rule.

SUMMARY: The Office of Thrift Supervision (OTS or Office) is today issuing a final rule updating, reorganizing, and substantially streamlining its lending and investment regulations and policy statements.

These amendments are being made pursuant to the Regulatory Reinvention Initiative of the Vice President's National Performance Review (Reinvention Initiative) and section 303 of the Community Development and Regulatory Improvement Act of 1994 (CDRIA), which requires OTS and the other federal banking agencies to review, streamline, and modify regulations and policies to improve efficiency, reduce unnecessary costs, and remove inconsistent, outmoded, and duplicative requirements.

. . . .

SUPPLEMENTARY INFORMATION:

. . . .

Paragraph (f) of § 545.33 specifies which OTS regulations must be followed by state savings associations and certain other state lenders who elect to make loans under

the Alternative Mortgage Parity Act.[8] The Alternative Mortgage Parity Act preempts state laws that might otherwise limit certain state creditors' ability to offer alternative mortgage instruments if they comply with the OTS regulations identified in this paragraph. OTS proposed moving paragraph (f) in order to make it more accessible and easier to locate and to clarify that all OTS lending regulations apply to loans originated under the Parity Act. OTS received no comments on this proposed change. Accordingly, OTS is moving the provisions of this paragraph, as modified to reflect changes elsewhere in today's final rule, into new § 560.220, as part of a subpart specifically dealing with alternative mortgages. The title of that subpart and § 560.220, will highlight the content, making it easier for those unfamiliar with OTS's regulations to locate.

. . . .

SECTION-BY-SECTION ANALYSIS:

. . . .

Subpart C—Alternative Mortgage Transactions

. . . .

Section 560.220 Alternative Mortgage Parity Act

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[8] The Alternative Mortgage Parity Act, Pub. L. 97-320, Title VII (Parity Act), 12 U.S.C. 3801 *et seq.*, authorizes certain housing creditors to make alternative mortgage transactions notwithstanding any contrary state law under certain conditions. Housing creditors that rely on the Parity Act and are not commercial banks or credit unions must comply with applicable OTS lending regulations.

This section (originally proposed as § 560.210) is derived from current § 545.33(f), "Notice of housing creditors regarding alternative mortgage transactions" and applies to state savings associations and certain other state-chartered lenders. OTS has observed that state housing creditors interested in engaging in alternative mortgage transactions could not easily locate § 545.33(f). Placing these provisions into a subpart specifically dealing with alternative mortgages will make them more accessible. The section has been streamlined and modified to remove cross-references to repealed provisions and to clarify the scope of federal lending regulations applicable to state housing creditors electing to originate loans under the Parity Act. While the proposal indicated that all of new Part 560 would be considered appropriate and applicable to the exercise of the authority under the Parity Act, the final rule has been revised to identify the appropriate sections with greater specificity. One commenter suggested adding language to clarify that this section does not limit the preemption of the imposition of state licensing requirements on federal associations. Because of modifications made to the final preemption regulation at § 560.2, OTS believes that the addition of this language is not necessary. States may not impose lending license requirements on federal thrifts.

. . . .

Accordingly, and under the authority of 12 U.S.C. 1462a, the Office of Thrift Supervision amends chapter V, title 12, Code of Federal Regulations, as set forth below.

. . . .

Subpart C—Alternative Mortgage Transactions

§ 560.210 Disclosures for adjustable-rate mortgage loans, adjustment notices, and interest-rate caps.

. . . .

§ 560.220 Alternative Mortgage Parity Act

Pursuant to 12 U.S.C. 3803, housing creditors that are not commercial banks, credit unions, or Federal savings associations may make alternative mortgage transactions as defined by that section and further defined and described by applicable regulations identified in this section, notwithstanding any state constitution, law, or regulation. In accordance with section 807(b) of Public Law 97-320, 12 U.S.C. 3801 note, §§ 560.33, 560.34, 560.35, and 560.210 of this part are identified as appropriate and applicable to the exercise of this authority and all regulations not so identified are deemed inappropriate and inapplicable. Housing creditors engaged in credit sales should read the term "loan" as "credit sale" wherever applicable.

Supreme Court, U.S.
FILED
JUL 13 2001
CLERK

No. 0-1851

IN THE SUPREME COURT OF THE UNITED STATES

E. JOSEPH FACE, JR., COMMISSIONER OF FINANCIAL INSTITUTIONS, BUREAU OF FINANCIAL INSTITUTIONS, VIRGINIA STATE CORPORATION COMMISSION, and SUSAN E. HANCOCK, DEPUTY COMMISSIONER, BUREAU OF FINANCIAL INSTITUTIONS, VIRGINIA STATE CORPORATION COMMISSION,

Petitioners,

v.

NATIONAL HOME EQUITY MORTGAGE ASSOCIATION,

Respondent.

ON PETITION FOR A WRIT OF *CERTIORARI* TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF *CERTIORARI*

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38 pp

COUNTERSTATEMENT OF THE QUESTION PRESENTED

1. Whether this Court should decline to issue a writ of certiorari to review a finding by a unanimous panel of the United States Court of Appeals for the Fourth Circuit holding that the Virginia statutes limiting prepayment penalties on home mortgages are preempted by federal law where that finding is not in conflict with the decision of any other federal or state appellate court and simply involves the application of settled law to undisputed facts?

THE PARTIES

The National Home Equity Mortgage Association is a national trade association focusing primarily upon the home equity lending market. Members of this voluntary trade association include banks, mortgage lending corporations, secured equity lenders, law firms, title insurers, consulting firms, and appraisal services corporations. Its membership includes entities that are licensed by the Bureau of Financial Institutions, Virginia State Corporation Commission, to conduct business in the Commonwealth of Virginia, and that also qualify as housing creditors under the Alternative Mortgage Transaction Parity Act of 1982, 12 U.S.C. §§ 3801-06.

E. Joseph Face, Jr. is the Commissioner of Financial Institutions, Bureau of Financial Institutions, Virginia State Corporation Commission. He is responsible for the division that administers state laws regulating financial services institutions licensed by the Bureau. He executes and enforces state policy initiatives directly affecting NHEMA members licensed to conduct business in the Commonwealth of Virginia who also qualify as housing creditors under the Parity Act.

Susan E. Hancock is the Deputy Commissioner, Consumer Finance, Bureau of Financial Institutions, Virginia State Corporation Commission. She is responsible for the administrative section which examines and supervises the operations of financial services institutions (except for state-chartered banks and credit unions) licensed by the Bureau. She executes and enforces state policy initiatives directly affecting NHEMA members licensed to conduct business in the Commonwealth of Virginia who also qualify as housing creditors under the Parity Act.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Sup. Ct. R. 29.6, Respondent National Home Equity Mortgage Association hereby discloses that it is a national trade association as noted *supra*, that it has no parent corporation, and that there is no publicly held company that owns 10% or more of its stock.

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REASONS FOR DENYING THE WRIT 10

1. Petitioners' first claim that the Parity Act abrogates constitutional prerogatives was not raised to the panel below and is without merit because the Parity Act represents a valid exercise of Congress' plenary authority under the Commerce Clause and does not violate Tenth Amendment rights. 12

2. Petitioners' second argument that the court of appeals did not reconcile the preemptive reach of the Parity Act with DIDA was not raised below and is not meritorious. 16

3. Petitioners' theory that the panel below "concluded, erroneously, that Virginia law was preempted, because [it] (1) failed to construe [the Parity Act] as a whole, (2) failed to consider post-enactment FHLBB actions under [the Parity Act], and (3) misconstrued the 'history' surrounding [the Parity Act's] enactment" is plainly wrong. 17

CONCLUSION 23

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OTS Extends Federal Preemption to HELOCs, Nat'l Mortgage News, Apr. 21, 1997 3

Respondent National Home Equity Mortgage Association ("NHEMA") respectfully requests this Court to deny the Petition for Writ of Certiorari to review the unanimous panel decision of the United States Court of Appeals for the Fourth Circuit. The court of appeals applied well-settled law to undisputed facts to conclude that Virginia statutes limiting prepayment penalties on home mortgages, Va. Code Ann. §§ 6.1-330.83 & 6.1-330.85, are preempted by 12 U.S.C. §§ 3801-06 (the "Parity Act"), which has the stated Congressional purpose of allowing state-chartered housing creditors to make, purchase, and enforce alternative mortgage transactions on equal terms with competing federally chartered entities "notwithstanding any State constitution, law, or regulation"[1] to the extent that their "transactions are in conformity with the regulations issued by the Federal agencies."[2]

OPINIONS BELOW

Petitioners have correctly cited the official reports of the opinions and orders entered below. Although Petitioners have correctly replicated the panel decision below, (Pet. Writ Cert. at 23a-36a), their recital of the district court's decision contains minor typographical errors at pages 6a-7a, and 11a.[3]

STATEMENT OF JURISDICTION

Respondent does not dispute Petitioner's Statement of Jurisdiction. (Pet. Writ Cert. at 1.)

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[1] 12 U.S.C. § 3803(c).

[2] 12 U.S.C. § 3801(b).

[3] There are additional typographical errors in their Appendix at pages 37a-38a, 45a, 57a, 60a-65a, 71a-72a, 75a-76a, and 78a-79a. However, it does not appear that these errors result in any material misrepresentation of the authorities reproduced in their Appendix.

COUNTERSTATEMENT OF THE CASE

I. Background.

In the late 1970s and early 1980s, the home mortgage lending market deteriorated due to "increasingly volatile and dynamic changes in interest rates" that impaired "the ability of housing creditors[4] to provide consumers with fixed-term, fixed-rate credit secured by interests in real property . . . and . . . dwellings." 12 U.S.C. § 3801(a)(1) (internal footnote added). *See also* Nat'l Home Equity Mortgage Ass'n v. Face, 239 F.3d 633, 635 (4th Cir. 2001) (reproduced in Pet. Writ Cert. at 25a.)

Congress recognized this trend and found that federal regulations governing alternative mortgage transactions[5] had heavily favored federally chartered lending institutions to the detriment of credit availability and stability. Because these transactions were deemed "essential to the provision of an adequate supply of credit secured by residential property necessary to meet the demand during the 1980s," 12 U.S.C. § 3801(a)(2), Congress enacted the Parity Act to create a level playing field for all housing creditors and to eliminate any discriminatory impact that federal regulations applicable to federally chartered lenders had upon state-regulated lenders. 12 U.S.C. § 3801(a)(3), (b).

The Parity Act satisfied these objectives by allowing state-chartered housing creditors to make, purchase, and

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[4] The Parity Act defines the term "housing creditor" in relevant part as "any person who regularly makes loans, credit sales, or advances secured by interests in properties . . . or any transferee of them." 12 U.S.C. § 3802(2)(C)-(D).

[5] The Parity Act defines the term "alternative mortgage transaction" at 12 U.S.C. § 3802(1). A quintessential alternative mortgage transaction is an adjustable rate mortgage. 12 U.S.C. § 3802(1)(A).

enforce alternative housing transactions in accordance with federal law "notwithstanding any State constitution, law, or regulation" to the extent that such transactions conformed to a series of regulations issued by the Director of the Office of Thrift Supervision ("OTS") for federally chartered savings and loan associations. 12 U.S.C. § 3803(a)(3), (c) (quotation from 12 U.S.C. § 3803(c)).[6]

Notwithstanding this express preemption provision in the Parity Act, Congress afforded each state the opportunity to opt out of the federal preemption scheme between October 15, 1982, and October 15, 1985, by enacting, or adopting by referendum or constitutional amendment, a new law, stating explicitly by its terms, that that state "does not want the preemption provided in [12 U.S.C. § 3803(c)] to apply with respect to alternative mortgage transactions (or to any class or type of alternative mortgage transaction) subject to the laws of such state", with exceptions not relevant to this case. 12 U.S.C. § 3804(a). Only six states timely opted out of the Parity Act's operation in the statutorily prescribed manner.[7]

The Commonwealth of Virginia admittedly failed to enact or adopt any such law. (Pet. Writ Cert. at 4) ("Some five or six states did opt-out; Virginia did not."). By acts not passed within the mandatory opt-out period and not citing to the Parity Act, the Virginia General Assembly purported to cap and regulate prepayment penalties on mortgages issued within the Commonwealth, including alternative mortgage transactions made by lenders or housing creditors subject to

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[6] The Director of the OTS has rulemaking authority under 12 U.S.C. §§ 1463(a) & 1464(a) to regulate federally chartered entities, and has given them the federal right to charge uncapped prepayment penalties on their alternative mortgage transactions. 12 C.F.R. § 560.2(a), (b)(5).

[7] OTS Extends Federal Preemption to HELOCs, Nat'l Mortgage News, Apr. 21, 1997 (noting that "loans made in the other 44 states can be made in accordance with OTS rules on late charges, prepayments, interest rate adjustments and ARM disclosures") (available at 1997 WL 8644294).

federal law under the Parity Act. *See* 1987 Va. Acts ch. 622, *codified at* Va. Code Ann. §§ 6.1-330.83 & 6.1-330.85.

Because Virginia did not opt out of the Parity Act's operation, state-chartered housing creditors licensed by the Bureau of Financial Institutions, Virginia State Corporation Commission, were able to make, purchase, and enforce their alternative mortgage transactions pursuant to the panoply of federal regulations that apply to federally chartered housing creditors "notwithstanding any State constitution, law, or regulation." 12 U.S.C. § 3803(c).

Pursuant to its rulemaking authority and 12 U.S.C. § 3803(a)(3), the FHLBB identified a set of federal regulations that must be adhered to before state-chartered housing creditors could invoke the benefits of federal law. Although the initial set of threshold regulations did not include the one allowing federally chartered housing creditors to charge contractually agreed-to prepayment penalties without any cap, this benefit was still made available to state-chartered housing creditors meeting the prerequisites set forth in the Parity Act.

In other words, if a state-chartered housing creditor adhered to that set of regulations identified by the FHLBB, then it could operate on par with federally chartered lenders, and the same law – federal law, including the ability to charge prepayment penalties without limitation and notwithstanding any contrary state statute – would apply to it. This is what Congress intended when it enacted the Parity Act and this is the regime that applied when the OTS as the successor agency to the FHLBB engaged in rulemakings to realize the stated purposes of the Parity Act. *See* 12 U.S.C. § 3801.

Consequently, in 1996, the OTS issued an opinion concluding that the Parity Act should be interpreted to

preempt a Wisconsin state statutory restriction on prepayment penalties. Effect of Parity Act on Wisconsin Prepayment Penalty Statute, OTS Op. Chief Counsel, 1996 OTS LEXIS 19 (Apr. 30, 1996) (reproduced in Pet. Writ Cert. at 71a-77a). It also issued a rule which explicitly stated that prepayment penalties are covered by the Parity Act. 61 Fed. Reg. 50,951, 50,954 (1996) (adopting 12 C.F.R. § 560.220 as a new regulation amending 12 C.F.R. § 545.33(b), so that 12 C.F.R. § 560.34 governing prepayment penalties would be identified as being applicable to any alternative mortgage transactions.) In 1997, the Maryland Attorney General ruled to the same effect as the OTS opinion. 82 Md. Op. Att'y Gen. No. 97-018 (Aug. 19, 1997) (available at 1997 Md. AG LEXIS 22).[8]

Thus, the OTS has stated in both an opinion letter and by rule that its regulation allowing federally chartered lenders to charge prepayment penalties is applicable to alternative mortgage transactions made by state-chartered lenders in states that failed to opt out of the preemption provision of the Parity Act.

The OTS is authorized by 12 U.S.C. § 3803(a)(3) to promulgate regulations governing alternative mortgage

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[8] *See also* Debtor/Creditor -- Prepayment Penalties, N.J. L.J., May 18-24, 2000 ("Although the [New Jersey] Prepayment Law, by its terms, applies to plaintiffs' mortgage loan, the court finds that it is preempted by the [Parity Act]. In failing to opt out of the Parity Act, New Jersey chose to accept the federal 'regime'; it cannot now rescind its decision to accept the Act's presumption merely because it disagrees with the Office of Thrift Supervision's current regulations. A paramount purpose of the Act is to create parity between state and federal lenders who engage in AMTs. The court finds that the 1996 opinion and the OTS's regulations governing prepayment penalties are, to the extent that they preempt state law, a permissible interpretation of the congressional authority vested in the OTS under the Parity Act.") (discussing the effect of Shinn v. Encore Mortgage Servs., Inc., 96 F. Supp. 2d 419 (D.N.J. 2000)).

transactions to the extent that the OTS has the power to issue regulations governing federally chartered institutions. Both the Parity Act and its legislative history, respectively, permit and envision that this authority will be exercised from time to time. *Id.* (referring to regulations "as issued" by the OTS); S. Rep. 97-463 at 55 (noting the Congressional expectation that "any future amendments that the agencies [including the OTS] make to regulations that are within the score of this title will conform to the objectives of this title"). The OTS has now exercised this authority to clarify that the federal regulation regarding prepayment penalties applies to alternative mortgage transactions made, purchased, and enforced in conjunction with the Parity Act. (*See* Pet. Writ Cert. at 78a-79a.) The terms of the Parity Act do not limit the scope of the agency's rulemaking authority.

II. Events Giving Rise to This Litigation.

In April 1999, an official newsletter authorized by the Petitioners was issued to Virginia mortgage and consumer finance licensees. The feature article announced Petitioners' contention that the Parity Act does not preempt Virginia statutory laws limiting prepayment penalties on alternative mortgage transactions. Federal Preemption of Virginia's Prepayment Penalty Laws, Compliance Connection, April 1999, at 1, 3 [hereinafter "Compliance Connection"] (reproduced in Pet. Writ Cert. at 68a-70a).

Speaking on behalf of the Virginia State Corporation Commission's Bureau of Financial Institutions, this article stated that housing creditors exercising their federal right to charge prepayment penalties exceeding Virginia's statutory caps would be subject to a series of punitive measures.

> Bureau examiners will continue to cite violations of Virginia statutes relating to prepayment penalties. Licensees found in

> violation will be required to refund prepayment penalties collected, in excess of the state law limits. In addition, notification of Virginia's limit on prepayment penalties must be provided to current borrowers so they will be aware that any higher penalty cannot be enforced. A copy of the notification must be made a part of the permanent loan file, and investors who have purchased loans providing for penalties in excess of the penalty set forth in the Virginia Code must also be notified.
>
> In addition to possible revocation of license, such violations can be referred to the Attorney General's office for investigation pursuant to Virginia Code § 6.1-430.

Compliance Connection at 3 (reproduced in Pet. Writ Cert. at 69a-70a).

III. Procedural History.

On June 1, 1999, NHEMA filed in the United States District Court for the Eastern District of Virginia a Verified Complaint for Declaratory Relief and Preliminary and Permanent Injunctions for Violation of 42 U.S.C. § 1983. In its Verified Complaint, NHEMA asserted *inter alia* that the "Supremacy Clause guarantees that federal laws made under the authority of the United States shall prevail over contrary state laws" and that Congress through the Parity Act created immediately enforceable rights under 42 U.S.C. § 1983. (Verified Compl. ¶¶ 31-32) (quotation at ¶ 32). NHEMA sought appropriate declaratory and injunctive relief, as well as an award of reasonable attorneys' fees and costs under 42 U.S.C. § 1988. (*Id.*, Prayer for Relief, ¶¶ 1-3.)

By order dated June 14, 1999, the district court issued a preliminary injunction that barred Petitioners from

> enforcing with respect to any alternative mortgage transaction made by a housing creditor in compliance with the [Parity Act], [Petitioners'] announced position that such compliance will nonetheless not preempt Va. Code §§ 6.1-330.83 and 6.1-330.85.

(Order June 14, 1999, at 1) (reproduced in the Appendix to this Brief in Opposition at A-1).

After reviewing the oral and written arguments made by the parties in support of their cross-motions for summary judgment, the district court granted NHEMA's motion, denied Petitioners' cross-motion, and "permanently enjoin[ed] [Petitioners] from enforcing their announced position that the Parity Act does not preempt Virginia state law limiting prepayment penalties on alternative mortgage transactions." Nat'l Home Equity Mortgage Ass'n v. Face, 64 F. Supp. 2d 584, 586 (E.D. Va. 1999), *aff'd*, 239 F.3d 633 (4th Cir. 2001) (reproduced in Pet. Writ Cert. at 2a).[9]

Petitioners appealed this decision to the United States Court of Appeals for the Fourth Circuit. In their appellate briefs, Petitioners generally argued that the Parity Act did not prevent them from enforcing Va. Code Ann. §§ 6.1-330.83

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[9] It also denied the Cross-Motion for Summary Judgment filed by the Honorable Mark L. Earley, Attorney General of Virginia, who intervened in the district court proceedings. Although the Attorney General's Office joined in Petitioners' appeal to the court of appeals, it has filed a Waiver with this Court stating that it now only represents the Attorney General's interests and that the Attorney General is not a party to the Petition for Writ of Certiorari filed by Petitioners. (Letter from A. Ann Berkebile, Assistant Attorney General, Commonwealth of Virginia, to William K. Suter, Clerk, Supreme Court of the United States 1 & attach. (June 29, 2001).)

and 6.1-330.85. (Br. Appellants at 9-28; Reply Br. Appellants at 1-19.) They did not argue in the court of appeals, as they seek to do here, that the Parity Act violates the Tenth Amendment or that the Parity Act has to be harmonized by the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA").

In a unanimous decision, a three-judge panel affirmed the district court's conclusion that the Parity Act preempted conflicting Virginia statutes. After examining general preemption principles defined by opinions of this Court, as well as the express language and legislative history of the Parity Act, the panel noted that in "enacting the Parity Act, Congress clearly intended to preempt state law"[10] and concluded that

> non-federally chartered housing creditors in Virginia – as they are defined in 12 U.S.C. § 3802(2) – may elect to have their alternative mortgage transactions governed by the federal law applicable to federally chartered housing creditors engaging in similar transactions by complying with that law, and when they do, that law, which includes 12 C.F.R. § 560.34 (regulating prepayments and authorizing a prepayment fee), preempts Va. Code Ann. §§ 6.1-330.83 and 6.1-330.85. This conclusion is required by 12 U.S.C. § 3803 and is clearly consistent with the raison d'etre of the Parity Act – giving State-chartered lending institutions parity with federally chartered lending institutions. *See* 12 U.S.C. § 3801(b).

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[10] Nat'l Home Equity Mortgage Ass'n, 239 F.3d at 637 (reproduced in Pet. Writ Cert. at 29a).

Nat'l Home Equity Mortgage Ass'n, 239 F.3d at 640 (reproduced in Pet. Writ Cert. at 35a-36a).

A Petition for Writ of Certiorari followed, raising two issues that were not argued to the court of appeals and a third that does not present "an important question of federal law that has not been, but should be, settled by this Court . . . ." Sup. Ct. R. 10(c).

REASONS FOR DENYING THE WRIT

This § 1983 action is a garden-variety case of federal preemption of state law under the Supremacy Clause. In 1982, Congress responded to the widespread concerns that unduly restrictive state laws hindered the competitiveness of state-chartered housing creditors and home mortgage lenders vis-à-vis their federally chartered counterparts. Congress' chosen solution was to create a federal safe harbor whereby state-chartered lenders could avail themselves of more liberal federal lending rules by complying with an identified set of federal regulations. Nat'l Home Equity Mortgage Ass'n, 239 F.3d at 640 (noting that if "a state lender conforms to the regulations listed in the regulation implementing § 807(b) [of the Parity Act], then it will enjoy the preemptive protection that the Act grants in 12 U.S.C. § 3803(c)").

Petitioners challenge the federal government's power to take this action on three grounds, two of which were not raised in the court of appeals below.

Their constitutional argument that the panel decision "sanctions an abrogation of Virginia's constitutional prerogatives, under the Tenth Amendment of the Constitution of the United States, without Virginia's knowing consent" was not raised to the court of appeals. (Pet. Writ Cert. at 10-11) (quotation at 10). Likewise, their argument that "[t]he decision of the appeals court failed to

reconcile properly the preemptive reach of [the Parity Act] with the preservation of state prepayment penalty laws under [DIDA])" was not presented to the panel for its consideration. (Pet. Writ of Cert. at 11-12) (quotation at 11). These arguments have been waived.

Nevertheless, even if these arguments were properly before this Court, they would be unavailing. Petitioners' essential contention is that the public policy of the Commonwealth of Virginia with respect to this area of law is frustrated by the preemptive effect of the Parity Act. In other words, their core argument is that State public policy should prevail over that adopted by Congress. This outcome is exactly what the Supremacy Clause[11] was designed to prevent, particularly when as here a core area of Congress' delegated powers is implicated.

Petitioners' third argument is that "[t]he appeals court concluded, erroneously, that Virginia law was preempted . . . ." (Pet. Writ of Cert. at 13-23) (quotation at 13). The Fourth Circuit affirmed the district court's conclusion that Congress fully intended the Parity Act to preempt conflicting state law in those states like Virginia that did not timely opt out of its operation in the statutorily prescribed manner. This conclusion is amply supported by this Court's preemption jurisprudence and does not conflict with any federal or state court decision.

Congress made the determination that consumers are better served by having greater credit availability and more credit options for home mortgage financing. The fact that

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[11] "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution of Laws of any State to the Contrary notwithstanding." U.S. Const. art. VI, § 2.

Congress struck a different balance than that reached by the Virginia General Assembly (or the Virginia State Corporation Commission's Bureau of Financial Institutions) is an unexceptional characteristic of federal preemption cases like this one.

Because this § 1983 action involves purely an issue of federal statutory interpretation and the operation of the Supremacy Clause, and because it neither raises any unique statutory issue nor presents any conflict in the interpretation of federal law, the Petition for Writ of Certiorari should be denied.

1. Petitioners' first claim that the Parity Act abrogates constitutional prerogatives was not raised to the panel below and is without merit because the Parity Act represents a valid exercise of Congress' plenary authority under the Commerce Clause and does not violate Tenth Amendment rights.

Petitioners' assertions that "[l]aws governing lending practices traditionally have been a state police law prerogative" and that both "the 1996 OTS actions and the judgment of the appeals court in this case effectively deprive Virginia of its Tenth Amendment legislative authority without fair notice" should be summarily rejected. (Pet. Writ Cert. at 10-11.)

First, it is well-settled that Petitioners' failure to raise its Tenth Amendment argument in their appellate briefs below prevents this Court from analyzing it now on certiorari.[12] *See, e.g.*, Blessing v. Freestone, 520 U.S. 329,

[12] There are no "exceptional circumstances" present that should compel a contrary conclusion. *See* Heckler v. Campbell, 461 U.S. 458, 469 n.12 (1983) (noting that this Court will review issues not raised below "'only in exceptional circumstances'") (citation omitted).

340 n.3 (1997) (declining to consider two issues in part because they had not been raised below); Delta Air Lines, Inc. v. August, 450 U.S. 346, 362 (1981) ("Although defendant's petition for certiorari presented the question of the District Judge's abuse of discretion in denying defendants costs under Rule 54(d), that question was not raised in the Court of Appeals and is not properly before us. We therefore affirm the judgment of the Court of Appeals."); Davis v. United States, 495 U.S. 472, 489 (1990) ("Because this argument was neither raised before nor decided by the Court of Appeals, we decline to address it here.") (citations omitted); Breininger v. Sheet Metal Workers Int'l Ass'n Local Union No. 6, 493 U.S. 67, 94 n.18 (1989) (refusing to consider claim "because [it] was neither presented to nor decided by the Court of Appeals below, and thus is not properly before us").

In addition to Petitioners' procedural default,[13] their argument necessarily fails on the merits because the Parity Act implicates Congress' core and plenary powers under the Commerce Clause[14] and concerns an area of commerce that has historically been subject to pervasive federal legislation.

Congress' power to regulate the instrumentalities and items of interstate commerce is not only plenary in nature, Cleveland v. United States, 329 U.S. 14, 19 (1946); Hodel v. Virginia Surface Mining and Reclamation Ass'n., Inc., 452 U.S. 264, 276 (1981), but also "complete in itself" since it "may be exercised to its utmost extent, and acknowledges no

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[13] The district court had correctly rejected Tenth Amendment arguments raised by Petitioners in their cross-motion for summary judgment. Nat'l Home Equity Mortgage Ass'n, 64 F. Supp. 2d at 591-92 (reproduced in Pet. Writ Cert. at 13a-15a).

[14] "The Congress shall have the Power to . . . . regulate Commerce . . . among the several States" and to "make all Laws which shall be deemed necessary and proper for carrying into Execution the foregoing Power[] . . . ." U.S. Const. art. I, § 8, cl. 1, 3, 18.

limitations, other than are prescribed by the Constitution." Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 196 (1824); Hodel, 452 U.S. at 276; United States v. Carolene Prods. Co., 304 U.S. 144, 147 (1938); United States v. Darby, 312 U.S. 100, 114 (1941). Furthermore, the commerce power extends to the Congressional regulation of local activities posing substantial and harmful effects upon interstate commerce. *See* Fry v. United States, 421 U.S. 542, 547 (1975); Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241, 258 (1964); Katzenbach v. McClung, 379 U.S. 294, 302 (1964). Congress having found that the activities being regulated negatively affect interstate commerce, federal courts "need inquire only whether the finding is rational." Hodel, 452 U.S. at 277.

From this structure, it "follows that no form of state activity can constitutionally thwart the regulatory power granted by the commerce clause to Congress." United States v. Wrightwood Dairy Co., 315 U.S. 110, 119 (1942). Hence, this Court has approved "any number of federal statutes enacted under the commerce power that [effectively] pre-empt particular exercises of state police power," Hodel, 452 U.S. at 292 (citations omitted), expressly rejecting arguments that Congress invades subject matters purportedly "reserved to the States by the Tenth Amendment simply because it exercises its authority under the Commerce Clause in a manner that displaces the States' exercise of their police powers." *Id.* at 291 (citations omitted).

It is obvious here that Congress in approving the Parity Act exercised its plenary Commerce Clause powers because (1) banking constitutes a recognized form of interstate commerce, United States v. Citizens and S. Nat'l Bank, 422 U.S. 86, 91 (1975), (2) loans secured by interests in real property are recognized forms of banking, 12 U.S.C. § 3801, and (3) the legislative history of the Parity Act demonstrates that alternative mortgage lending "is essential

to the maintenance of an adequate supply of housing credit for the Nation . . . ." S. Rep. 97-463, at 54 (1982).

The area being regulated here is not converted into a matter of exclusive state concern by labeling it "consumer protection." (*See* Pet. Writ Cert. at 8) ("Virginia and other states . . . regard their laws restricting prepayment penalties as important protections for their citizens . . . ."). Federal law is a major repository for consumer protection legislation in the consumer finance arena, as is readily evinced by Congressional enactment of the Real Estate Settlement Procedures Act, 12 U.S.C. §§ 2601 *et seq.*, the Fair Credit Reporting Act, 15 U.S.C. §§ 1681 *et seq.*, the Truth in Lending Act, 15 U.S.C. §§ 1601 *et seq.*, and the Federal Debt Collections Practices Act, 15 U.S.C. §§ 1692, *et seq.* These laws provide crucial substantive and legal protections for consumers largely because Congress clearly expressed its intent, like it did in the Parity Act, that federal safeguards will preempt conflicting state statutes regulating the same subject area. *See, e.g.*, RESPA Reg. X, 24 C.F.R. § 3500.13, 12 U.S.C. foll. § 2617; 15 U.S.C. § 1681t; 15 U.S.C. § 1610; 15 U.S.C. § 1692n.

The district court below correctly held that "the borrowing and lending of money is commerce that falls within Congress' broad commerce power" and observed that "this area is not clearly reserved to the states under the Tenth Amendment." Nat'l Home Equity Mortgage Ass'n, 64 F. Supp. 2d at 592 (reproduced in Pet. Writ Cert. at 14a-15a). "[W]hen the power is delegated, as it is here through the Commerce Clause, then the power of Congress is plenary and it can act to the exclusion of laws of the states." *Id.* (reproduced in Pet. Writ Cert. at 15a).

2. Petitioners' second argument that the court of appeals did not reconcile the preemptive reach of the Parity Act with DIDA was not raised below and is not meritorious.

Petitioners' argument that the Parity Act should be construed and harmonized with DIDA is a novel claim that was not raised before the Court of Appeals and should not be considered by this Court. *See* Delta Air Lines, *supra*; Davis, *supra*; Breininger, *supra*; and other related cases cited in § 1.

Notwithstanding their failure to preserve this point, this argument is clearly meritless. First, there is no established equivalency between the Parity Act and DIDA so that they should be construed *in pari materia*. *See* Grunbeck v. The Dime Sav. Bank of N.Y., FSB, 74 F.3d 331, 343 (1st Cir. 1996) (noting that "'the Parity Act and the Monetary Control Act serve related but distinctly different functions'") (citation omitted).

Second, Petitioners state that both the Parity Act and DIDA pertain to "federally related mortgage loans."[15] (Pet. Writ Cert. at 11.) This fatally undermines Petitioners' Tenth Amendment and "no federal preemption" arguments because "federally related mortgage loans" are encompassed within Congress' plenary Commerce Clause powers and are subject to federal, not state, statutes and regulations.

Third, their belief that DIDA allows states to regulate or cap prepayment penalties on mortgages that are subject to the Parity Act is in open conflict with the express language of the Parity Act. (Pet. Writ Cert. at 12.) While Petitioners maintain that prepayment penalties are not preempted under DIDA at 12 U.S.C. § 1735f-7a, Congress stated in the Parity Act, which was enacted after DIDA, that "[s]ection 501(c)(1)

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[15] This term is also defined under RESPA at 12 U.S.C. § 2602(1).

of [DIDA] [now 12 U.S.C. § 1735f-7a] shall not apply to transactions which are subject to [the Parity Act]." 12 U.S.C. § 3805.

Petitioners' assertion that "the decision below results in conflicting state and federal rules relating to prepayment penalties applying to the same loan" is a *non sequitur*. The Parity Act precludes the application of 12 U.S.C. § 1735f-7a, and regulations like 12 C.F.R. § 590.3(c) adopted thereunder, to alternative mortgage transactions, and it further overrides conflicting state statutes like Va. Code Ann. §§ 6.1-330.83 & 6.1-330.85 that frustrate Congressional intent by denying parity in those states like Virginia that did not opt out of federal preemption under 12 U.S.C. § 3804(a).

3. Petitioners' theory that the panel below "concluded, erroneously, that Virginia law was preempted, because [it] (1) failed to construe [the Parity Act] as a whole, (2) failed to consider post-enactment FHLBB actions under [the Parity Act], and (3) misconstrued the 'history' surrounding [the Parity Act's] enactment" is plainly wrong.

First, their view that an uncodified note following 12 U.S.C. § 3801 "establishes the means of setting the bounds on [the Parity Act's] preemption of states' laws" is patently mistaken. (*Id.*) Section 807(b) of the Parity Act directed the FHLBB (and other agencies not relevant here) within sixty days of October 15, 1982, to

> identify, describe, and publish those portions of their . . . regulations that are inappropriate for (and thus inapplicable to), or that need to be conformed for the use of, nonfederally

> chartered housing creditors to which their . . . regulations apply . . . .

12 U.S.C. § 3801, note.

The FHLBB identified regulations that it would not apply to non-federally chartered housing creditors, the FHLBB publishing at 12 C.F.R. § 545.33(f) (1983), the regulations that it would require such lenders to follow in order to be on par with federally chartered housing creditors. All other regulations were declared inapplicable. (*See* Pet. Writ Cert. at 59a.) Significantly, housing creditors for single family dwellings for more than four families in the aggregate were not required to follow any federal regulations, but were instead completely deregulated and allowed to be covered by market forces.[16] 47 Fed. Reg. 51,732, 51,734 (1982).

Petitioners misread the framework of the Parity Act by contending that this uncodified note somehow limits the rulemaking authority of the OTS. (Pet. Writ Cert. at 13-18.) After all, the Parity Act itself had already put the states on clear notice that the subject of alternative mortgage transactions was being preempted by federal regulation with no restriction on the OTS' power to alter and amend those regulations. Congress merely required the OTS to identify those regulations that state-chartered housing creditors must

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[16] This decision highlights Petitioners' error in supposing that only those regulations listed pursuant to 12 U.S.C. § 3801, note, have preemptive effect and that all state laws on other subjects would continue to apply. If this were indeed so, then the fact that no federal regulations apply to certain categories of housing creditors would mean that the transactions that they would make, purchase, or enforce would be entirely subject to state law. This would contradict the intended purpose of the Parity Act, namely that nonfederally and federally chartered housing creditors and banking institutions be subject to the same set of laws when they make, purchase, and enforce alternative mortgage transactions in compliance with applicable OTS regulations and that that same set of laws be federal laws.

obey before they can avail themselves of federal preemption under the Parity Act.[17]

The Parity Act reveals that Congress never ordered the OTS to specify which regulations would or would not have preemptive effect on "any State constitution, law or regulation." 12 U.S.C. § 3803(c). Instead, Congress notified state-chartered housing creditors that if they complied with whatever regulations were specified in 12 C.F.R. § 545.33(f), they had the capacity and right to make, to purchase, and to enforce alternative mortgage transactions in full parity with federally chartered institutions "notwithstanding any State constitution, law, or regulation." *Id.*

Hence, it is inconsequential whether the FHLBB initially identified and published in 12 C.F.R. § 545.33(f) the federal regulation permitting federally chartered housing creditors to charge prepayment penalties subject to the terms of the loan contract. Housing creditors merely had to follow and comply with those regulations that were identified and published before being able to make, purchase, and enforce alternative mortgage transactions without regard to any state constitution, law, or regulation, including state laws like Va. Code Ann. §§ 6.1-330.83 & 6.1-330.85 purporting to cap

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[17] Congress obviously required the agency to identify which regulations would apply to state-chartered housing creditors so that those creditors would have a reliable understanding of the criteria they must meet before they could avail themselves of federal preemption under the Parity Act. This is shown by the fact that when the FHLBB initiated rulemaking proceedings in 1982, and also in 1996 when the OTS amended the list to include the federal regulation permitting prepayment penalties, it provided notice to housing creditors, not states. 47 Fed. Reg. 51,732, 51,732 (1982); 61 Fed. Reg. 50,951, 50,953 (1996). Contrary to Petitioners' claims, there is no evidence that § 3801 was drafted for the convenience of states wishing to opt out under 12 U.S.C. § 3804(a). Indeed, it is apparent on its face that § 3801 was drafted to insure that federal regulations would properly "fit" state-chartered housing creditors.

prepayment penalties. Of course, the OTS has since expressly clarified this analytical framework by amending 12 C.F.R. § 545.33 to include 12 C.F.R. § 560.34, which permits the use of a prepayment penalty subject to terms of the loan contract, and by recasting 12 C.F.R. § 545.33(f) into the current 12 C.F.R. § 560.220.[18]

Now, so long as (1) a state did not opt out of federal preemption in the prescribed manner set forth in 12 U.S.C. § 3804(a) and (2) a housing creditor complies with the applicable OTS regulations listed by 12 C.F.R. § 560.220, including the regulation permitting prepayment penalties subject to the terms of the loan contract, a housing creditor can avail itself of federal preemption under the Parity Act.

Petitioners' argument that the uncodified note at 12 U.S.C. § 3801 required a list to be issued in sixty days and that this requirement prevented the OTS from ever changing its regulations thereafter as they apply to state-chartered institutions is contrary to both the text and the purpose of the Parity Act and to all known tenets of administrative law. (Pet. Writ Cert. at 13-18.)

Congress provided in 12 U.S.C. § 3803(a)(3) that state-chartered housing creditors may make, purchase, and enforce alternative mortgage transactions if they first comply with identified "regulations governing alternative mortgage transactions as issued by the Director of the [OTS] for federally chartered savings and loan associations, to the extent that such regulations are authorized by rulemaking authority granted to the Director of the [OTS] with regard to

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[18] (*See* Pet. Writ Cert. at 78a-79a.) The district court correctly concluded that the OTS' actions were entitled to deference under Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-43 (1984). Nat'l Home Equity Mortgage Ass'n, 64 F. Supp. 2d at 590 (reproduced at Pet. Writ Cert. at 10a.)

federally-chartered savings and loan associations under laws other than this section." (emphasis added).

There is no temporal limit stated in the statute and the "as issued" language gave notice that there was no such limit. Obviously, there is no canon of construction that would allow an uncodified note to limit the OTS' expressly granted rulemaking authority. Furthermore, the creation of any limitation of the type urged by Petitioners would defeat the stated purpose of the Parity Act by having regulations applicable to state and federally chartered housing creditors diverge over time rather than remain in parity. Finally, the legislative history of 12 U.S.C. § 3801 shows that regulations governing nonfederally chartered housing creditors are amendable. S. Rep. 97-463 at 55 (quoted *supra* at 6).

Therefore, the 1996 OTS rulemaking proceeding to amend the list of regulations applying to state-chartered housing creditors to include the federal regulation allowing prepayment penalties was a valid exercise of administrative authority in accordance with the Parity Act. And, of course, Virginia made no timely challenge to that rulemaking under the Administrative Procedure Act, 5 U.S.C. §§ 551, *et seq.*

The court of appeals court was clearly correct when it concluded that under

> the Parity Act and the regulations, to which it explicitly refers . . . when a non-federally chartered housing creditor elects to be governed by federal law and complies with that law, it may charge a contractually specified prepayment fee as authorized by federal law, despite the fact that Virginia law provides otherwise. Any other rule would contradict the explicit language of 12

> U.S.C. § 3803(c) which provides that 'an alternative mortgage transaction may be made by a housing creditor in accordance with this section, notwithstanding any State constitution, law, or regulation.' It would also deny the non-federally chartered housing creditor parity with federal institutions when entering into alternative mortgage transactions.

Nat'l Home Equity Mortgage Ass'n, 239 F.3d at 639 (reproduced at Pet. Writ Cert. at 33a.)

Petitioners[2] overarching argument that the Parity Act did not and does not preempt Virginia's statutes limiting prepayment penalties and that the 1996 regulations were unauthorized is simply incorrect.

The decision below was not only correct, but was the only possible one which would vindicate the stated purpose of the Parity Act:

> It is the purpose of this title to eliminate the discriminatory impact that those [federal] regulations have upon nonfederally chartered housing creditors and provide them with parity with federally chartered institutions by authorizing all housing creditors to make, purchase, and enforce alternative mortgage transactions so long as the transactions are in conformity with the regulations issued by the Federal agencies.

12 U.S.C. § 3801(b).

CONCLUSION

Tellingly, Petitioners cite no case law to support their contentions that Va. Code Ann. §§ 6.1-330.83 & 6.1-330.85 are not preempted by federal law pursuant to the Parity Act. Because their convoluted arguments are squarely contrary to the legislative history and language of the Parity Act, or are doctrinally wrong, and because the decision below applying settled law to undisputed facts neither conflicts with other federal or state appellate court decisions nor presents unique questions of federal statutory interpretation, the Petition for a Writ of Certiorari should be denied.

Respectfully Submitted,

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No. 0-1851

IN THE SUPREME COURT OF THE UNITED STATES

E. JOSEPH FACE, JR., COMMISSIONER OF FINANCIAL INSTITUTIONS, BUREAU OF FINANCIAL INSTITUTIONS, VIRGINIA STATE CORPORATION COMMISSION, and SUSAN E. HANCOCK, DEPUTY COMMISSIONER, BUREAU OF FINANCIAL INSTITUTIONS, VIRGINIA STATE CORPORATION COMMISSION,

Petitioners,

v.

NATIONAL HOME EQUITY MORTGAGE ASSOCIATION,

Respondent.

ON PETITION FOR A WRIT OF *CERTIORARI* TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

APPENDIX TO BRIEF IN OPPOSITION TO PETITION FOR WRIT OF *CERTIORARI*

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APPENDIX

FILED
Jun 14 1999
Clerk, U.S.
District Court
Richmond, VA
/s/ DSA

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF VIRGINIA
Richmond, Virginia

NATIONAL HOME EQUITY MORTGAGE ASSOCIATION	)	
Plaintiff,	)	
	)	Case No.: 3:99cv398
E. JOSEPH FACE, JR., et al.	)	
Defendants.	)	

ORDER

On June 11, 1999, the parties came before the Court on the plaintiff's motion for a preliminary injunction. The Court having considered the verified complaint, the affidavits submitted by the parties, and the briefs and argument of counsel under the factors set forth in Blackwelder Furn. Co. v. Seilig Mfg. Co., 550 F.2d 189 (4th Cir. 1977), is of the opinion that a preliminary injunction

should issue. WHEREFORE defendants are enjoined from enforcing with respect to any alternative mortgage transaction made by a housing creditor in compliance with the Alternative Mortgage Transaction Parity Act of 1982, 12 U.S.C. § 3801 *et seq.*, (the "Act"), defendants' announced position that such compliance will nonetheless not preempt Va. Code §§ 6.1-330.83 and 6.1-330-85. The Court is informed that plaintiff does not seek a determination that any individual transaction complies with the Act, and this injunction does not address the rights of defendants with regard to that issue.

This injunction shall become effective upon the plaintiff's filing a letter of credit in the amount of Ten Thousand and No/100 Dollars ($10,000.00), conditioned according to law. The injunction shall continue until further order of the Court.

ENTERED: June 14, 1999

/s/ Richard L. Williams
UNITED STATES DISTRICT JUDGE

I ask for this:

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Supreme Court, U.S.
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No. 0-1851

In the Supreme Court of the United States

E. Joseph Face, Jr., Commissioner of Financial Institutions, Bureau of Financial Institutions, Virginia State Corporation Commission, ET AL.,
Petitioners,

v.

National Home Equity Mortgage Association,
Respondent.

On Petition For Writ of Certiorari
To The United States Court of Appeals
For The Fourth Circuit

BRIEF OF THE OFFICE OF THE KANSAS STATE BANK COMMISSIONER, AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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16 pp

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INTEREST OF THE AMICI CURIAE

This case addresses the appropriate scope concerning the preemption of state consumer protection laws by federal statutes and agency rules regarding mortgage financing. Specifically, the preemption of state prepayment penalty restrictions or prohibitions concerning alternative mortgage transactions made in accordance with Title VIII of the Garn-St. Germain Act of 1980. A state's ability to enact and enforce borrower protection measures is of great significance and any federal statute or rule that interferes with that ability should be narrowly tailored to achieve its desired effect. The State of Kansas, as well as any state that has laws limiting or prohibiting prepayment penalties, will be affected by the Court's decision. Other states and officials have expressed their intent to participate in this action as *Amici Curiae* and will be identified in subsequent filings with the Court. Consent to file this brief was granted by all parties, in accordance with Supreme Court Rule 37(2)(a).[1]

SUMMARY OF ARGUMENT

The Office of the Kansas State Bank Commissioner is in complete agreement with the position advanced by the Petitioners. In the early 1980's, Congress enacted a number of laws designed to alleviate volatile and increasingly high market interest rates and the resulting inability of lenders to make home mortgage loans at fixed interest rates. Consistently, such legislation involved measures to increase the availability of alternative mortgage transactions ("AMTs") for both State and Federal lenders. Prepayment penalties are not, however, an inherent part of AMT and

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[1] No counsel for a party to this action authored this brief, in whole or in part, and no other person or entity made a monetary contribution to the preparation or submission of this brief.

there exists no indication that Congress intended to preempt state laws limiting or prohibiting the same.

ARGUMENT

FEDERAL LEGISLATIVE MATERIALS CONCERNING THE PASSAGE OF THE ALTERNATIVE MORTGAGE TRANSACTION PARITY ACT ("AMTPA") ARE COMPLETELY VOID OF ANY INDICATION THAT CONGRESS INTENDED THE PREEMPTION OF STATE LAWS LIMITING OR PROHIBITING PREPAYMENT PENALITES.

As stated by the Petitioners, the legislative history of AMTPA is "sparse." (Pet. App. At 20) Although Petitioners' brief adequately identifies and addresses a majority of the legislative history concerning the passage of AMTPA, there exists some additional information that may be helpful to the Court.

On April 7, 1981, the Senate held the first of many hearings concerning the great distress plaguing the home finance industry caused, primarily, by a period of overwhelming inflation.[2] Senator Jake Garn was the Chairman of the Committee on Banking, Housing, and Urban Affairs at the time, and was present at the Hearing. Jerry Pohlman, the Vice President and Chief Economist for California Federal Savings & Loan made the following statement at the Hearing:

> [T]he development of new mortgage instruments is fundamental for successful adjustment to our current economic

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[2] *Federal Role in Conventional Home Financing: Hearing Before the Subcommittee on Housing and Urban Affairs of the Committee on Banking, Housing and Urban Affairs*, 97th Cong., 1st Sess. 13 (1981).

> environment. The problem we face today is rooted in the persistent and seemingly intractable inflation we have witnessed in recent years. . . . Thrifts' extensive use in the past of the long-term, fixed-rate conventional mortgage is the prime reason why the bulk of associations are experiencing operating losses. Like other financial intermediaries, S. & L.'s income depends upon the difference between what they pay on savings and other investments and the interest they receive on loans. . . . It is ignoring reality to believe that thrifts can pay rapidly changing market rates on deposits to keep savers abreast of inflation without having mortgage interest rates vary as well. In order for thrifts to survive . . . they will have to offer mortgages which have yields that vary with the market. In times like these, following the traditional path of borrowing short and lending long will only push thrifts down a road which leads to insolvency and result in an even more devastating impact on funds available for housing.[3]

Cantwell F. Muckenfuss III, Senior Deputy Comptroller for Policy, Comptoller of the Currency, made the following Statement during the Hearing:

> First of all, inflation and resulting high and volatile interest rates have had devastating effects on housing and housing finance in recent months. Those financial institutions

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[3] *Id.* at 33 & 44.

> whose portfolios are composed primarily of long-term fixed-rate mortgages have suffered a precipitous drop in earnings as their cost of funds have risen well above the average return on their portfolios. . . . The 30 year fixed-rate mortgage is a venerated element of our system of housing finance and it has served the Nation well. The move to a world of greater flexibility was revolutionary. Our office did not take action to facilitate this change lightly.
>
> Yet we firmly believe that changed circumstances demanded this step. Other steps, equally dramatic, may be required if we are to fight inflation and at the same time continue our commitment to a "decent home and suitable living environment" for every American.[4]

Also included within the Hearing record, which exceeds 200 pages, are statements made by Robert McKinney, Chairman, First Federal Savings & Loan Association; John Dalton, Chairman, Federal Home Loan Bank Board; Emanual Savas, Assistant Secretary for Policy Development and Research, Department of Housing and Urban Development; David Kresge, Director, Harvard-MIT Joint Center for Urban Studies; William Silber, Professor, Graduate School of Business, N.Y.U.; and Kent Colton, Professor, Graduate School of Management, B.Y.U. The overriding concern of each of the Committee, and each expert witness that presented testimony at the Hearing, was combating inflation, and providing funds for homebuyers, by ensuring that financial institutions had the ability to offer adjustable rate mortgages. Prepayment penalties were never mentioned by the Committee, or any expert witness, and there is no

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[4] *Id.* at 80 & 84.

indication that either considered prepayment penalties as an inherent aspect of, or an impediment to, AMTs.

On December 10, 1981, the House of Representatives held a similar hearing concerning the persistent and seemingly intractable inflation, which was affecting the home finance industry.[5] Representative Fernand J. St. Germain, Chairman, asked his Committee the following question, "Should Federal law provide a preemption of state usury ceilings – on consumer loans and in modified form on business and agricultural loans – with states having a time period within which to reimpose state ceilings, or should a national usury law be enacted?" In response, Representative Bill McCollum made the following statement:

> The Chairman's opening statement raises an issue that I think, Mr. Pierce and Mr. Phillips, is important to all members. That is with regard to housing and maintenance of an adequate level of housing. I would like to ask each of you, how can we assure proper flow of funds to housing in a deregulated banking environment? . . . What is to assure us in the future, if the thrift institutions become more like banks, and banks become more like everybody else and the playing field is leveled, that we are going to have bankers or the new level playing field, or whatever nature they are, to put money in housing and make those kinds of commitments which apparently commercial interests today don't find as nice or as profitable?

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[5] *Financial institutions in a revolutionary era: Hearing Before the Committee on Banking, Finance and Urban Affairs, House of Representatives*, 97th Cong., 1st Sess. 72 (1981)

Obviously, the overriding concern of the Committee was ensuring an adequate level of available financing for the purchase of homes by this Nation's citizens, through the use of adjustable rate mortgages. Again, the Hearing record is completely void of any reference to prepayment penalties. Such omission is a clear indication that Congress did not associate prepayment penalties as an inherent or integral part of AMTs, nor did they view state law limitations on prepayment penalties as one of the problems.

LEGISLATION ENACTED BY CONGRESS PRIOR TO AMTPA, WHICH WAS DESIGNED TO ALLEVIATE THE INFLATIONARY PROBLEMS PLAGUING THE MORTGAGE INDUSTRY, SUPPORT PETITIONER'S ARGUMENT.

In 1980, two years prior to the enactment of AMTPA, Congress enacted the Depository Institutions Deregulation and Monetary Control Act ("DIDMCA"). Under Title V of DIDMCA, federal lenders were provided an exemption to state interest rate limits on "federally related mortgage loans" as defined in 12 U.S.C. § 1735f-5(b). "Federally related mortgage loans," are defined by 12 U.S.C. 1735f-5(b) as:

[A]ny loan which--

> **(1)** is secured by residential real property designed principally for the occupancy of from one to four families; and
>
> **(2)(A)** is made in whole or in part by any lender the deposits or accounts of which are insured by any agency of the Federal Government, or is made in whole or in part by any lender which is itself regulated by any agency of the Federal Government; or

> **(B)** is made in whole or in part, or insured, guaranteed, supplemented, or assisted in any way, by the Secretary of Housing and Urban Development or any other officer or agency of the Federal Government or under or in connection with a housing or urban development program administered by the Secretary of Housing and Urban Development or a housing or related program administered by any other such officer or agency; or
>
> **(C)** is eligible for purchase by the Federal National Mortgage Association, the Government National Mortgage Association, or the Federal Home Loan Mortgage Corporation, or from any financial institution from which it could be purchased by the Federal Home Loan Mortgage Corporation; or
>
> **(D)** is made in whole or in part by any "creditor", as defined in section 1602(f) of Title 15, who makes or invests in residential real estate loans aggregating more than $1,000,000 ~~per year~~.

AMTs are, therefore, "federally related mortgage loans." When enacting DIDMCA, however, Congress specifically stated that "other charges" shall not be construed to mean prepayment charges, attorneys' fees, late charges, or other borrower protection provisions applicable to home mortgage loans.[6] Specifically, 12 C.F.R. § 590.3 states, . . . (c) Nothing in this section preempts limitation in state laws on

[6] S. Rep. No. 368, 96 Cong. 2d Sess. 19 reprinted in 1980 U.S.C.C.A.N. 236, 255.

prepayment charges, attorneys' fees, late charges or other provisions designed to protect consumers. Additionally, regulations by the Office of the Thrift Supervision ("OTS"), promulgated under DIDMCA, contain the same language (See, 12 C.F.R. § 590.3(c)). Therefore, DIDMCA, which by definition would include an "alternative mortgage transaction," would have to be read in contravention of AMTPA, as well as the rule of statutory construction applicable to laws in pari material, given the decisions adopted by the courts below. Finally, it is important to note that an AMT does not need to contain a prepayment penalty to qualify as an AMT.[7]

CONCRESS DID NOT INTEND TO GIVE FEDERAL AGENCIES THE AUTHORITY TO EXPAND THE SCOPE OF AMTPA'S STATE LAW PREEMPTION THOUGH REGULATIONS THAT AUTHORIZE CONTRACTUAL PREPAYMENT PENALTIES IN CONTRAVENTION OF STATE LAWS.

In AMTPA, Congress provided that state chartered housing creditors may **make, purchase, and enforce** AMTs if they comply with regulations issued by the appropriate federal agency, to the extent that such regulations are authorized by rulemaking authority. In Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-43, 104

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[7] 12 U.S.C. § 3802(1) defines an "alternative mortgage transaction as: a loan or credit sale secured by an interest in residential real property. . . (A) in which the interest rate or finance charge may be adjusted or renegotiated; (B) involving a fixed-rate, but which implicitly permits rate adjustments by having the debt mature at the end of an interval shorter than the term of the amortization schedule; or (C) involving any similar type of rate, method of determining return, term, repayment, or other variation not common to traditional fixed-rate, fixed-term transactions, including without limitation, transactions that involve the sharing of equity or appreciation; described and defined by applicable regulations; . . .

S.Ct. 2778, 81 L.Ed.2d 694 (1984), the Supreme Court addressed the proper deference that should be given to a federal agency's interpretation of a statute. In doing so the Court held, "[If] the plain language of the statute addresses the precise issue . . . . that is the end of the matter because courts as well as agencies must give effect to the unambiguously expressed intent of Congress." Clearly, AMTPA provides authority to the Federal agencies to promulgate regulations that are necessary to allow state-chartered banks and housing creditors to "make, purchase, and enforce" AMTs. Any federal regulation that exceeds this purview should not be included within the preemptive implication of AMTPA.

Upon passage, AMTPA directed the appropriate federal agencies to "identify, describe and publish (and conform as necessary) their AMT-enabling regulations. In response, the FHLBB published three "Notice(s) to Housing Creditors."[8] In those three publishings, the FHLBB clearly omitted any reference to regulations concerning prepayment penalties. In fact, FHLBB stated the following during its May 23, 1983 rulemaking:

> The Board's approach to the applicability of its regulations is premised on the clear statement of Congressional intent that Title VIII "does not place non-federally chartered housing creditors under the supervision of the federal agencies, but instead merely enables them to follow a federal program as an alternative to state law.' S. Rep. No. 97-463, 97th Cong., 2d Sess. 55. The Notice to Housing Creditors should, therefore, identify as appropriate those regulations that further "describe and define" (section 803(1)) alternative mortgage transactions, and not

[8] See, 47 F.R. 51733, 48 F.R. 23076, and 49 F.R. 43043.

> those regulations intended for the general supervision of Federal Associations.

In that same document, the FHLBB went on to identify and list the regulations that it deemed appropriate for carrying out the intent of AMTPA. Regulations authorizing the use of prepayment penalties were not included. Finally, although AMTPA does provide that subsequent changes in federal regulations are authorized to carry out the intent of the Act, it does not mean that federal agencies are free to expand the scope of AMTPA to include areas outside the original intent of Congress and, thereby, preempt more state laws. Federal agencies have confused their limited role granted by Congress under § 807(b) of AMTPA by expanding its scope to include application of federal regulations concerning prepayment penalties.

As this Court has held, Congress's intent to preempt must be "clear and manifest: to preempt state law in a field traditionally occupied by the states, such as the exercise of a state's police powers.[9] Additionally, a state's police powers extend to issues of consumer protection, such as the limitation or prohibition of prepayment penalties, and a presumption against preemption should apply to the present action.[10]

Clearly, those federal agencies that have extended the preemptive effect of AMTPA to include prepayment penalties have done so without authority granted by Congress and in degradation of a state's right to protect its citizens.

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[9] Medtronic, Inc. v. Lohr, 518 U.S. 470, 485, 116 S.Ct. 2240, 135 L.Ed.2d 700 (1996).

[10] California v. ARC America Corp., 490 U.S. 93, 109 S.Ct. 1661, 104 L.Ed.2d 86 (1989).

CONCLUSION

For the foregoing reasons, the Office of the Kansas State Bank Commissioner respectfully urges the Court to reverse the lower court decision.

Respectfully submitted,

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IN THE
Supreme Court of the United States

E. JOSEPH FACE, JR., COMMISSIONER OF FINANCIAL INSTITUTIONS, BUREAU OF FINANCIAL INSTITUTIONS, VIRGINIA STATE CORPORATION COMMISSION, ET AL.,
Petitioners,

v.

NATIONAL HOME EQUITY MORTGAGE ASSOCIATION,
Respondent.

On Petition For Writ of Certiorari
To The United States Court of Appeals
For The Fourth Circuit

REPLY TO BRIEF IN OPPOSITION

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ARGUMENT

A.

With regard to Respondent's Counterstatement of the Question Presented (Opp. Brief, at p. i), whether or not certiorari should be granted is certainly a decision to be made by the Court, but is not a "question presented" within the meaning of Rule 14.

B.

With regard to the third paragraph of Part I of Respondent's Counterstatement of the Case (Opp. Brief, at pp. 2, 3), Petitioners observe that the "Parity Act", as enacted, made no mention of the Office of Thrift Supervision ("OTS") or its Director because, of course, neither the OTS nor its Director existed in 1982. The OTS never "issued", in any sense of that word, any regulation under the Parity Act until, possibly, 1996.

With regard to the fifth paragraph (Opp. Brief, at pp. 3, 4), the language used conveys the false impression that Virginia's statutory limits on prepayment penalties chargeable on home mortgage loans originated in 1987, or were somehow related to or influenced by the 1982 Parity Act. In fact, the restrictions contained in §§ 6.1-330.83 and 6.1-330.85 of the Code of Virginia originated in 1946 with enactment of Chapter 386 of Virginia Acts of Assembly of that year. A one percent prepayment penalty restriction was then imposed under § 4168-b(23) of the Code of Virginia.

With regard to assertions in Part III of Respondent's Counterstatement of the Case, and elsewhere in its Brief In Opposition, that arguments founded upon (1) legislative prerogatives reserved to the states under the Tenth Amendment, and (2) the specific preservation of state laws relating to prepayment penalties in connection with

enactment of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA") were not made in the courts below and are therefore waived, Petitioners state that the record below belies these assertions. For example, we quote Petitioner's opening brief in the court below – "Moreover, although the Depository Institutions Deregulation and Monetary Control Act of 1980, 12 U.S.C. § 1735f-7, preempted many state laws affecting first mortgage loans, Congress chose not to preempt laws governing prepayment penalties, a field left historically to State control."

C.

Petitioners do not assert, as claimed by Respondents (Opp. Brief, pp. 9, 12-15), that the Parity Act itself "violates the Tenth Amendment." Contrariwise, Petitioners assert that a 1996 action by the OTS, as interpreted by it and the courts below, invaded an area preserved by prior Congressional enactment (DIDA) and the provision of a three-year opt-out period under the Parity Act. Nor do Petitioners challenge Congress' power to preempt state law under the Commerce Clause; rather, Petitioners assert that Congress' intended preemptive reach under the Parity Act was less broad than Respondent claims. To this proposition, Respondent makes no rejoinder.

With regard to the argument in part 2 of the Reasons for Denying the Writ (Opp. Brief, pp. 16, 17), in addition to denying any procedural default, Petitioners note that in order for statutes to be deemed in pari materia, it is not necessary that they be legally identical or functionally equivalent. They need only touch upon the same subject matter (see authorities cited in the Petition for Certiorari, at p. 12). Second, it does not follow from the fact that a particular home mortgage loan is a "federally related mortgage loan," as defined under 12 U.S.C. § 1735f-5(b), that every facet and

feature of it is governed by federal rather than state law. Thirdly, § 501(c)(1) of DIDA is not now 12 U.S.C. § 1735f-7a but 12 U.S.C. § 1735f-7a(c)(1). The latter pertains to the sale and financing of mobile homes, a subject that is not at issue in this case.

With regard to part 3 of Respondent's Reasons for Denying the Writ, Petitioners note that the language "... housing creditors for single family dwellings for more than four families" (Opp. Brief, p. 18) is anomalous. Respondents also invoke the Administrative Procedure Act, 5 U.S.C. §§ 551 et seq. (Opp. Brief, p. 21) for the first time in this case. Respondent's failure to refer to this law or make any argument founded upon it in the courts below operates to prevent consideration of it in this Court under the same authorities cited in its brief (Opp. Brief, pp. 12, 13, 16).

The remainder of part 3 consists of argument founded upon a literalistic reading of the language "notwithstanding any State constitution, law or regulation" used by Congress in the Parity Act to express its preemptive intent, 12 U.S.C. § 3803(c), which Respondent repeats like a mantra. Respondents would have the Court construe this language to preempt all state laws, perhaps even those laws having nothing to do with money lending. Such a position is clearly untenable. Congress explicitly preserved state home mortgage lender licensing laws in the Parity Act itself at 12 U.S.C. § 3802, requiring that non-federal housing creditors abide by such state laws as a condition to availing themselves of the Parity Act's benefits. Under Respondent's theory of the preemptive reach of the Parity Act, state-chartered lenders could lawfully impose a condition in an alternative mortgage transaction agreement that a homeowner's minor child be apprenticed to the lender until attaining his or her majority contrary to state compulsory education laws, provided that the lender otherwise complied

with applicable OTS regulations. Such a result is absurd, but fits Respondent's theory of the law.

CONCLUSION

Respondents ask the Court to view this matter as a "garden variety" federal preemption case. Petitioners believe that the possibly tens or hundreds of thousands of American homeowners held captive under high rate "alternative" home mortgage loan agreements providing for steep prepayment penalties view the issues raised by this case in a different light. To them, to Petitioners, and to the many states having laws restricting prepayment penalties on home mortgage loans, this is a case of imperative public consequence.

The petition for a writ of certiorari should be granted.

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